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# In the Supreme Court of the United States

OCTOBER TERM, 1995

AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,
*Petitioner,*

v.

UNITED STATES OF AMERICA.

**Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit**

## PETITION FOR A WRIT OF CERTIORARI

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## QUESTION PRESENTED

The life insurance industry is composed of two segments: stock life insurance companies and mutual life insurance companies. Stock companies typically pay price rebates to policyholders and earnings dividends to shareholders. Under the tax laws, the former are deductible and the latter are not. Mutual companies, which have no shareholders, pay dividends only to their policyholders.

In 1984, Congress enacted Section 809 of the Internal Revenue Code to address a perceived need to "level the playing field" between stock companies and mutual companies. The underlying theory was that some portion of the dividends paid by mutual companies represented a return on policyholders' investment and therefore should be taxed like stock companies' shareholder dividends. To achieve this result, Congress adopted a mathematical formula that adjusts taxable income of mutual companies based on a comparison of the current one-year average of mutual company earnings rates with an adjusted average of stock company earnings rates for the previous three years. Although stock company earnings rates are generally higher in a year-by-year comparison with mutual company earnings rates, earnings rates in the insurance industry vary dramatically from year to year. The average mutual earnings rate for any one year, therefore, may well be higher than an average of stock earnings rates for the three prior years. Accordingly, when the current mutual earnings rate is subtracted from the average stock rate under Section 809's formula, a negative number may result.

The question presented is:

Whether the court of appeals misinterpreted Section 809, and thus authorized taxation of mutual companies at levels higher than those intended by Congress, when it chose to disregard those occasions on which the difference between prior years' average stock earnings rate and the current year's mutual earnings rate is a negative number.

## STATEMENT UNDER RULE 29.1

In accordance with Rule 29.1 of the Rules of this Court, petitioner American Mutual Life Insurance Company And Subsidiaries, states that it has no parent company, no subsidiaries (other than a wholly owned subsidiary, American Vanguard Life Insurance Company), and no affiliates. Petitioner further states that the issue presented in this federal income tax case arises in the case of every mutual life insurance company.

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## PETITION FOR A WRIT OF CERTIORARI

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American Mutual Life Insurance Company And Subsidiaries ("AMLI" or "Petitioner"), by its undersigned counsel, respectfully petitions for a writ of certiorari to review the judgment of the court of appeals in this case.

## OPINIONS BELOW

The opinion of the court of appeals (App. 1a-9a) is reported at 43 F.3d 1172. The opinion of the district court (App. 10a-17a) is reported at 1993 WL 556786; 73 A.F.T.R.2d (P-H) ¶ 94-301; and 93-2 U.S. Tax Cas. (CCH) ¶ 50,652.

## JURISDICTION

The judgment of the court of appeals was entered on December 15, 1994. A petition for rehearing and suggestion for rehearing en banc was denied on March 21, 1995. App. 20a. On June 9, 1995, Justice Thomas entered an order extending the time within which to file a petition for a writ of certiorari to and including July 19, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## STATUTORY AND REGULATORY PROVISIONS INVOLVED

This petition concerns the interpretation of Section 809 of the Internal Revenue Code of 1986, 26 U.S.C. § 809. Certain other sections of the Internal Revenue Code, 26 U.S.C. §§ 801, 803, 804, 805, 807, 808, and a United States Department of the Treasury regulation, 26 C.F.R. § 1.809-9, also are relevant. These sections and regulation are set forth in the appendix. App. 21a-32a.

## STATEMENT OF THE CASE

### A. Factual Background

The facts in this case are not disputed. AMLI is a mutual life insurance company organized and existing under the laws of the State of Iowa. In 1986, AMLI paid a total of $13,985,737 in policyholder dividends. Because AMLI is a mutual life insurance company, it was required to perform the calculations in Section 809 to determine whether and to what extent its policyholder dividend deduction should be reduced. Following the procedure mandated by Section 809(a), AMLI calculated its "differential earnings amount" by applying the "differential earnings rate" of 10.539 percent (published by the Treasury Department) to its 1986 average equity base, resulting in a differential earnings amount of $9,826,925. In accordance with Section 809(a), AMLI then reduced its Section 808 *policyholder dividends deduction* for 1986 from $13,985,737 to $4,158,812.

For the next tax year, 1987, Section 809(f) required AMLI to calculate a "recomputed differential earnings amount" for 1986. That amount consisted of applying the "recomputed differential earnings rate" to AMLI's 1986 average equity base. In March 1988, when the Treasury Department published its tentative recomputed differential earnings rate for 1986, that rate was —1.700 percent. *See* Announcement 88-47, 1988-12 I.R.B. 56. Using this rate, as adjusted, AMLI calculated a recomputed differential earnings amount of —$1,580,476 for its 1987 in-

come tax return pursuant to Section 809(f).[1] Subtracting the recomputed differential earnings amount of —$1,580,476 from the initial differential earnings amount of $9,826,925, as mandated by Section 809(f)(2), produced a result of $11,407,401.[2] AMLI therefore claimed a Section 809(f)(2) *life insurance deduction* of $11,407,401 for the 1987 tax year.

As a result of the life insurance deduction so calculated, AMLI had an increased loss for the tax year 1987, which it then carried back to 1984 and claimed a refund. The IRS initially granted that refund. In 1991, however, AMLI was assessed with a corporate income tax deficiency, relating to the recomputed differential earnings amount claimed on the 1987 federal income tax return. AMLI paid the amounts assessed in full. After its administrative protests were rejected, AMLI filed this action, seeking a refund.

**B. Section 809**

This dispute has its origins in the 1984 effort by Congress to adjust the relative tax burdens of the stock and mutual segments of the life insurance industry. Stock companies essentially make two kinds of dividend distributions: dividends to their policyholders (viewed as price rebates) and dividends to their shareholders (viewed as earnings distributions). The former are deductible from federal taxes at the corporate level, and the latter are not. Mutual life insurance companies also pay policyholder dividends. Because they have no shareholders, however, they do not pay any shareholder dividends. In 1984, Congress believed that policyholder dividends distributed by mutual companies include a component that is akin to the earnings distributions that stock companies

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[1] The tentative —1.700 percent rate was calculated by using a tentative 1986 average mutual earnings rate of 17.985 percent. When the 1986 average mutual earnings rate was later determined to be 17.980 percent, the 1986 recomputed differential earnings rate became —1.695 percent, the rate used by AMLI in its federal income tax filings.

[2] $9,826,925 — (—$1,580,476) = $11,407,401.

make to their shareholders and that should be taxed at the corporate level. It therefore enacted a mechanism to estimate and tax the earnings portion of mutual companies' policyholder dividends.

The overall tax scheme into which this complex mechanism was inserted is fairly simple. Life insurance companies must pay taxes on life insurance gross income reduced by life insurance deductions. App. 21a (§ 801 (b)). Deductions include, among other things, "policyholder dividends" and "other deductions." App. 22a (§ 805(a)(3) & (8)). Both stock and mutual companies are allowed to deduct policyholder dividends. App. 23a-24a (§ 808). Mutual companies, however, must apply the formulae of Section 809, and, over time, this acts to impute additional income and thus increases their taxes to take account of the theoretical earnings portion of their policyholder dividends. App. 24a-31a (§ 808(c)(2); 809).

The mechanism chosen by Congress rests on the theory that over a period of years mutual and stock companies, being in the same industry, can be expected to have comparable earnings rates, and that therefore the earnings portion of a mutual company's policyholder dividends can be estimated by comparing the earnings of stock companies before shareholder dividends with the post-dividend earnings of mutual companies. The difference between the earnings rates (the differential rate) would, according to this view, approximate the rate of mutual company equity returns that are comparable to shareholder dividends. *See* H.R. Rep. No. 432, 98th Cong., 2d Sess., pt. 2, 1422 (1984), *reprinted in* 1984 U.S.C.C.A.N. 697, 1067; S. Rep. No. 169, 98th Cong., 2d Sess., Vol. I, 548-49 (1984).

In Section 809, Congress adopted a mathematical formula that imputes additional income to mutual companies based on a comparison of the current one-year average of mutual company earnings rates with an adjusted average of stock company earnings rates for the three previous years. This imputation of income, operating as it does on

the basis of industry averages, divorces the tax liability of a mutual company from the amount of policyholder dividends paid in any given year. The formula operates in two stages: In the first year, mutual companies calculate a differential earnings amount and, in the second year, they calculate a recomputed differential earnings amount. The differential earnings amount is computed by multiplying the "life insurance company's average equity base for the taxable year" by the differential earnings rate for that year. App. 25a (§ 809(a)(3)). Because, for any given tax year, the current mutual earnings rate is not available at the time the year's returns must be filed, the differential earnings rate (DER) is computed by using the average mutual earnings rate for the second preceding year. For 1986, the DER is calculated as follows:

1986 DER = 1986 Imputed Earnings Rate − 1984 Average Mutual Earnings Rate.[3]

App. 27a (§ 809(c)(1)). The 1986 imputed earnings rate, in turn, is an adjusted average of the stock earnings rates for 1983, 1984, and 1985.[4] App. 28a (§ 809(d)). The recomputed differential earnings amount is calculated the same way, except it uses mutual data from 1986. For 1986, the recomputed differential earnings rate is calculated as follows:

Recomputed 1986 DER = 1986 Imputed Earnings Rate − 1986 Average Mutual Earnings Rate.

Although the theory behind estimating and taxing the earnings portion of mutual companies' policyholder dividends rested on a year-by-year comparison of data, the mechanism enacted by Congress does not in fact com-

[3] The "average mutual earnings rate" is the aggregate gain or loss from operations for that year of all mutual life insurance companies divided by the aggregate average equity bases for that year of all mutual life insurance companies. App. 30a (§ 809(e)).

[4] The stock earnings rate for a year is the numerical average of the earnings rates of the 50 largest stock life insurance companies for that year. App. 29a (§ 809(d)(4)). Under Section 809(d)(1), the imputed earnings rate for any year is a specified fraction (namely .9055) of the average of the stock earnings rates for the three prior years.

pare earnings rates from the same year. Both the initial and the recomputed differential earnings rates rely on comparisons of a one-year industry average on the mutual side with a three-year industry average on the stock side. Neither the differential earnings amount nor the recomputed differential earnings amount for a given year takes into account, even as part of the three-year average, the stock companies' earnings rate for that year. Therefore, there is no necessary relation between the differential earnings rate calculated under the statute and the actual difference in the earnings rates for any given year. Instead, as the following discussion shows, the statute, if allowed to work over time, will reach a consistent result by averaging.

By choosing a mechanism that compares average earnings rates over several years, Congress took a multi-year view of equalizing the taxation burdens of the mutual and stock segments of the life insurance industry. In this multi-year view, it is essential that all values be considered, including any negative values. Otherwise, the result is irrational and statistically invalid.

Because earnings rates of insurance companies vary significantly from year to year, the mutual earnings rates for one year will occasionally be higher than the adjusted average of stock earnings rates for three prior years, even when stock company rates are consistently higher in a year-to-year comparison with mutual company rates. Consider, for example, the following three charts showing hypothetical rates of return for stock and mutual companies.[5] The first assumes stable rates for both segments for all years. In that example, the recomputed differential earnings rate, not surprisingly, remains stable, and the average recomputed DER is, as expected, identical to the recomputed DER (RDER) for each individual year.

---

[5] To simplify the illustrations, we have not adjusted the average stock earnings rates by the 0.9055 percentage derived from Section 809(d)(1).

Example 1—Stable Rates

| | 1981-1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | Average Outcome 1986-89 |
|---|---|---|---|---|---|---|---|---|
| A. Stk. earn. rate | 16.5 | 16.5 | 16.5 | 16.5 | 16.5 | 16.5 | 16.5 | |
| B. 3-year avg. stk. earn. rates | | 16.5 | 16.5 | 16.5 | 16.5 | 16.5 | 16.5 | |
| C. Avg. mut. earn. rate | | 13.5 | 13.5 | 13.5 | 13.5 | 13.5 | 13.5 | |
| D. RDER (B minus C) | | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |

In the second example, the rates remain the same except there is a six percent *decrease* in both the mutual and the stock companies' earnings rates in 1986. As one would expect given the tandem movement in both stock and mutual companies' earnings rates, the *average* recomputed differential earnings rate remains unchanged. But in reaching that average, the recomputed differential earnings rate for 1986 is artificially high. The government and AMLI agree that, under Section 809, the tax liability of mutual companies in 1986 will reflect this artificially high result, just as it will also reflect the lower recomputed DERs in the three succeeding years.

Example 2—6 percent decrease in rates in 1986

| | 1981-1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | Average Outcome 1986-89 |
|---|---|---|---|---|---|---|---|---|
| A. Stk. earn. rate | 16.5 | 16.5 | 16.5 | 10.5 | 16.5 | 16.5 | 16.5 | |
| B. 3-year avg. stk. earn. rates | | 16.5 | 16.5 | 16.5 | 14.5 | 14.5 | 14.5 | |
| C. Avg. mut. earn. rate | | 13.5 | 13.5 | 7.5 | 13.5 | 13.5 | 13.5 | |
| D. RDER (B minus C) | | 3.0 | 3.0 | 9.0 | 1.0 | 1.0 | 1.0 | 3.0 |

In the final example, the rates remain the same except there is a six percent *increase* in both the mutual and the stock companies' earnings rates in 1986. Again, if

there are no artificial limits set, the average recomputed differential earnings rate remains the same as in the first two examples, which should be expected because the rates for the two segments are moving in tandem. The government, however, having reversed course during this litigation, now insists that a negative recomputed DER cannot exist and that any number that is calculated as negative must be replaced with a zero. Because this third chart illustrates the point at issue in this case, it contains two lines for the recomputed DER: $D_1$ showing the result urged by AMLI, and $D_2$ showing the result urged by the government. The result of the government's calculation is that, over time, the mutual insurance companies pay taxes based on a significantly higher average recomputed differential earnings rate (3.75 percent versus 3.0 percent) than was either provided for in Section 809 or contemplated by Congress. This is precisely the distortion that AMLI seeks to avoid.

Example 3—6 percent increase in rates in 1986

| | 1981-1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | Average Outcome 1986-89 |
|---|---|---|---|---|---|---|---|---|
| A. Stk. earn. rate | 16.5 | 16.5 | 16.5 | 22.5 | 16.5 | 16.5 | 16.5 | |
| B. 3-year avg. stk. earn. rates | | 16.5 | 16.5 | 16.5 | 18.5 | 18.5 | 18.5 | |
| C. Avg. mut. earn. rate | | 13.5 | 13.5 | 19.5 | 13.5 | 13.5 | 13.5 | |
| $D_1$. RDER per AMLI (B minus C) | | 3.0 | 3.0 | −3.0 | 5.0 | 5.0 | 5.0 | 3.0 |
| $D_2$. RDER per gov't | | 3.0 | 3.0 | -0- | 5.0 | 5.0 | 5.0 | 3.75 |

The skewing of the averages that results when negative values are not considered should hardly be surprising. Any investment fund, for example, would want to omit any years in which it had a negative earnings rate in calculating its average historical earnings rate. Unfortunately, that is not the real world. Any averaging of this kind must consider the negative values along with

the positive values for there to be any statistically-valid meaning to the exercise.

The government's only proposed justification for ignoring negative values is the assertion that Section 809's formulae must be limited by the amount of policyholder dividends paid in any particular year. Section 809's language, however, contains no such artificial limits. The required calculations simply are not tied to the amount of policyholder dividends paid in any given year. Section 809(a) provides in relevant part:

> (1) POLICYHOLDER DIVIDENDS.—In the case of any mutual life insurance company, the amount of the deduction allowed under section 808 shall be reduced (but not below zero) by the differential earnings amount.
>
> (2) REDUCTION IN RESERVE DEDUCTION IN CERTAIN CASES.—In the case of any mutual life insurance company, if the differential earnings amount exceeds the amount allowable as a deduction under section 808 for the taxable year (determined without regard to this section), such excess shall be taken into account under subsections (a) and (b) of section 807.

App. 24a (§ 809(a)(1) & (2)). In the first year, therefore, the amount of the policyholder dividend deduction is reduced by the differential earnings amount, but to the extent that the differential earnings amount is greater than the amount of policyholder dividends distributed by the company that year, the company's reserves are decreased, creating a dollar-for-dollar increase in the mutual company's gross income. *See* App. 24a; 23a (§ 809 (a)(2); § 807(a) & (b)). In other words, a mutual company must pay taxes on the full differential earnings amount calculated under Section 809, whether that amount is greater than the policyholder dividends paid by the company that year or not. Indeed, even if a mutual company paid no dividends in a year, it would still have to pay additional taxes under Section 809's imputation of income formulae.

Thus, Section 809's mechanism in the first step of the process clearly is independent of the amount of policyholder dividends paid by mutual companies. The Department of the Treasury acknowledged this point in its Final Report to Congress: "The imputation of equity income [in Section 809] was described as a limitation on policyholder dividend deductions, but in fact it is an income imputation. If the imputed income exceeds current policyholder dividends, the current reserve deduction is reduced by the excess." Department of the Treasury, *Final Report to The Congress on Life Insurance Taxation* 25 n.8 (Aug. 1989).

In the following year, Section 809 directs mutual life insurance companies to adjust their taxable income by the recomputed differential earnings amount. Section 809(f) provides in relevant part:

> (1) INCLUSION IN INCOME WHERE RECOMPUTED AMOUNT GREATER.—In the case of any mutual life insurance company, if—
>
> (A) the recomputed differential earnings amount for any taxable year, exceeds
>
> (B) the differential earnings amount determined under this section for such taxable year,
>
> such excess shall be included in life insurance gross income for the succeeding taxable year.
>
> (2) DEDUCTION WHERE RECOMPUTED AMOUNT SMALLER.—In the case of any mutual life insurance company, if—
>
> (A) the differential earnings amount determined under this section for any taxable year, exceeds
>
> (B) the recomputed differential earnings amount for such taxable year,
>
> such excess shall be allowed as a life insurance deduction for the succeeding taxable year.

App. 30a-31a (§ 809(f)(1) & (2)). Therefore, if the recomputed differential earnings amount is greater than

the first year's differential earnings amount, then the company must add the difference to its taxable income in that following year. App. 30a (§ 809(f)(1)). Because there is no limit to this part of the provision, the statute contemplates that the total amount added to a mutual company's income as a result of this section could easily exceed the amount of policyholder dividends paid by the company in the previous year. Therefore, like the first year's differential earnings amount, the recomputed amount is independent of the amount a company pays in policyholder dividends. Conversely, if the first year's differential earnings amount is greater than the recomputed amount, then the statute directs the company to take "such excess" as "a life insurance deduction" for that second year. App. 31a (§ 809(f)(2)). Once again, the section does not limit the operation of this provision to the amount of policyholder dividends paid by a company in any given year.

Petitioner's view that the statistically-valid reading of the statute must be the one intended by Congress finds support not only in logic but also in the government's own pre-litigation conduct. In implementing Section 809, the government, until it lost this case in the district court, agreed with AMLI that the intent of Congress was that the recomputed differential earnings rate could be negative. *See* App. 14a. Indeed, the government actually published the tentative recomputed differential earnings rate for 1986 as —1.700 percent. *See* Announcement 88-47, 1988-12 I.R.B. 56.[6] Furthermore, in its Reports to Congress, the Treasury Department never asserted that the word "excess" in the statute meant that the number had to be positive. Instead, it simply referred to the "difference between the differential earnings

[6] Even after the IRS announced that the recomputed differential earnings ratio could never be negative, it continued to publicly state that it had calculated other negative rates under Section 809. *See* Rev. Rul. 89-106, 1989-2 C.B. 109; Rev. Rul. 91-52, 1991-2 C.B. 331; Rev. Rul. 92-78, 1992-2 C.B. 143; Rev. Rul. 93-59, 1993-2 C.B. 244.

amount and the recomputed differential earnings amount." Department of the Treasury, *Interim Report to The Congress on Life Insurance Taxation* 5 (June 1988); *Final Report*, *supra*, at 8; *see also* S. Rep. No. 169, 98th Cong., 2d Sess., Vol. I, 552 (1984) (stating that statute will take account of "any difference" between the two differential earnings amounts). The Treasury Department also admitted that Section 809 was intended to operate over more than just one year. *See Interim Report, supra*, at 15 n.2 ("Tax liability generated from life insurance activity may affect tax payments in future years."). Reflecting the statute's multi-year approach, the Treasury Department declared that "Congress also believed that mutual and stock companies in the same industry will earn comparable rates of return on equity *over a period of several years.*" *Final Report, supra*, at 26 (emphasis added). These consistent and early pronouncements were in keeping with the language and legislative intent of Section 809 and with the interpretation of the statute that AMLI urges, and they culminated in the government's concession in the district court in this very case that the recomputed differential earnings rate could be negative.

**C. Procedural History**

AMLI filed this lawsuit on September 27, 1991, in the United States District Court for the Southern District of Iowa. The district court accepted the government's concession that the recomputed differential earnings rate could be negative, concluded that the life insurance deduction authorized by Section 809(f)(2) is not restricted by Section 808 of the Code, and accordingly ruled that AMLI was entitled to the full life insurance deduction claimed and therefore to the requested refund. App. 16a-17a.

The government appealed and withdrew its concession that the recomputed differential earnings rate could be negative. The government stated that that concession was inconsistent with the Treasury Department's revised interpretation of the statute (made only after losing the

case in the district court). Central to the government's argument was the assertion that in no event could the total deduction for a particular year (*i.e.*, the first-year policyholder dividend deduction plus the second-year life insurance deduction) be greater than the amount of policyholder dividends paid in that year. Therefore, according to the government, the recomputed differential earnings rate could never be negative. The court of appeals accepted the government's argument and reversed the decision of the district court. App. 7a. As the first sentence of the opinion demonstrates, the court's entire reasoning was based on the acceptance of the notion that the deductions permitted by Section 809 for any one year could never be greater than the amount of policyholder dividends paid in that year. App. 1a-2a. At no point did the court explain how or why this limitation was inserted into Section 809.

## REASONS FOR GRANTING THE PETITION

This case presents an issue of exceptional importance concerning the proper interpretation and administration of the federal income tax laws. The court of appeals read out of Section 809 an essential part of the mathematical formula contained in that section. By doing so, the court significantly increased the tax liabilities of mutual companies contrary to the plain meaning of the section and the legislative intent behind the section. The court also departed from the basic tenets of statutory interpretation.

Moreover, as the Department of Justice itself acknowledged in a press release touting its victory in the court of appeals, the legal issue presented in this case involves tax consequences of 5 *billion* dollars for the mutual life insurance industry. *See* Department of Justice Press Release, *Tax Attorney Received the John Marshall Award for Saving Tax Payers Five Billion Dollars* (June 22, 1995). That money would come from the more than 100 million mutual life insurance policyholders and beneficiaries in this country. Further, if the court of appeals' decision is allowed to stand, mutual life insurance com-

panies will be disadvantaged tremendously with respect to maintaining their already diminishing market share as against stock life insurance companies. Such a result would directly contradict the congressional intent of enacting a taxing mechanism that would level the playing field and not favor one segment of the industry over the other.

Finally, this case provides an ideal occasion for the Court to resolve this important issue. The record is complete and there are no factual disputes. The question was fully briefed and argued by the government and AMLI both in the district court and in the court of appeals. The statutory interpretation question is squarely presented. If this Court does not act now on this issue, a significant number of smaller mutual companies, whose audits have been completed for the tax years at issue, will need to initiate litigation in various federal courts to prevent the statute of limitations from running on their substantial claims. Neither this Court nor the federal judicial system nor the mutual companies would derive any benefit from postponing review until more and more cases are litigated in the lower federal courts.

For all of these reasons, which are explained more fully below, the Court should grant review and correct the court of appeals' misinterpretation of Section 809.

## I. THE COURT OF APPEALS IMPROPERLY APPLIED RULES OF STATUTORY INTERPRETATION AND IGNORED THE CLEAR LANGUAGE OF THE STATUTE AS WELL AS THE RECORD IN CONSTRUING SECTION 809 AS IT DID.

This case involves solely a question of statutory interpretation. There is no dispute that AMLI used the formulae in Section 809 to calculate its differential earnings amount and its recomputed differential earnings amount. The dispute centers on whether Section 809 allows for a negative recomputed differential earnings rate and therefore a negative recomputed differential earn-

ings amount. Petitioner contends that it does, and the court of appeals ruled that it does not.

The holding of the court of appeals is remarkable in its "blinders" approach to AMLI's position. The court did not disagree with AMLI that refusal to consider negative recomputed differential earnings rates would skew the results of the formulae over time. The court did not provide a statistical or rational reason why Congress would have required mutual companies to ignore the negative recomputed differential earnings rates. And the court did not deny that its ruling would treat mutual companies less favorably than stock companies, in contradiction to the stated congressional intent.

The court of appeals reached its erroneous result by accepting the government's invitation to subordinate Section 809 to Section 808, by disregarding the nature of the new taxation scheme that Congress enacted in 1984, and by accepting the simplistic but distorting notion that the two separate deductions authorized by Section 809 on successive returns could not be allowed under any circumstances to exceed the amount of dividends actually paid during the year in question.[7] From the court's very statement of the issue in the first paragraph of its opinion, it was off on the wrong track, incorrectly announcing, with the encouragement of the government, that the issue is "whether Congress intended to give mutual life insurance companies so-called dividend deductions greater than their dividends in any given year." App. 1a-2a. By thus emphasizing Section 808, which provides for the deduction of policyholder dividends on a year-by-year basis, the court demoted both the statutory language of Section

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[7] The court of appeals' shallowness of analysis is further revealed by its mischaracterization of AMLI's position, and by the syllogism that the Court then used to dismiss that misstated position: The heading of Section 809 refers to a *reduction* in a company's deduction; "AMLI's position is that it is entitled to a deduction *enhancement*"; therefore, AMLI's position must be incorrect. App. 5a. At each step of this syllogism, however, the court's logic is faulty as we further demonstrate below.

809, which provides multi-year formulae that are independent of Section 808, and the legislative intent underlying that provision.

### A. The Court Of Appeals Mistakenly Relied On The Heading Of Section 809 In Interpreting The Otherwise Plain Language Of Section 809.

This Court recently looked to the "plain language" of a section of the Internal Revenue Code as the most important guide to interpreting that section. *See Commissioner v. Schleier,* —— U.S. ——, 115 S. Ct. 2159, 2167 (1995). Here by contrast, the court of appeals discounted the plain language of Section 809, as well as the only statistically valid method for the statute's formulae to operate, and instead relied largely on the statute's heading. This was error.

In the court of appeals' view, the heading of Section 809—"Reduction in certain deductions of mutual life insurance companies"—requires that the total deductions authorized by the section for any given year be limited by the amount of policyholder dividends paid in that year. The heading itself is not so rigid; it refers only to a "reduction in *certain* deductions." Moreover, the Treasury Department has already admitted that the heading of Section 809 does not accurately reflect the actual text of the section and that the statutory mechanism enacted by Congress is not limited by the amount of dividends paid.

> The imputation of equity income [in Section 809] was described as a limitation on policyholder dividend deductions, but in fact it is an income imputation. If the imputed income exceeds current policyholder dividends, the current reserve deduction is reduced by the excess.

*Final Report, supra,* at 25 n.8. The Treasury Department's admission is compelled by the language of the statute, and it eviscerates the court of appeals' reliance on the heading as a guide to interpretation.

In any event, a heading of a section "is but a shorthand reference to the general subject matter involved."

*Brotherhood of Railroad Trainmen v. Baltimore & O.R.R.*, 331 U.S. 519, 528 (1947). This Court has explicitly held that

> headings and titles are not meant to take the place of the detailed provisions of the text. . . . [*T*]*he heading of a section cannot limit the plain meaning of the text.* . . . For interpretative purposes, they are of use only when they shed light on some ambiguous word or phrase. They are but tools available for the resolution of a doubt. But they cannot undo or limit that which the text makes plain.

*Id.* (emphasis added) (citations omitted); *see United States v. Minker*, 350 U.S. 179, 185 (1956); *Maguire v. Commissioner*, 313 U.S. 1, 9 (1941). As demonstrated below, the mathematical formulae enacted in Section 809 are unambiguous and the court of appeals' reliance on the heading to "limit that which the text makes plain" is incorrect.

As outlined above, Section 809 requires mutual companies to calculate two different numbers in two different years: the differential earnings amount, which can affect a mutual company's policyholder dividends deduction *and* reserves in the first year, and the recomputed differential earnings amount, which can affect a mutual company's gross income *or* life insurance deduction in the second year. As is evident from even this short summary of these calculations, the court of appeals' position that these calculations relate solely to the amount of policyholder dividends that a mutual company paid in a particular year is simply untenable. Contrary to the court's holding, the statutory language requires that these two calculations not be limited to the amount of policyholder dividends paid—either on the high or low end. Indeed, even if a mutual company pays no policyholder dividends in a particular year, Section 809 can require it to impute additional income and pay an increased tax.

Section 809 clearly provides that both the differential earnings amount and the recomputed differential earnings

amount are independent of the policyholder dividends paid in any given year. The statutory formula imposes a potentially unlimited tax liability on mutual companies. The calculation in the first year provides that "the deduction allowed under section 808 shall be reduced (but not below zero) by the differential earnings amount." App. 24a (§ 809(a)(1)). Only to the extent that Congress specifically provided that the (a)(1) deduction cannot go "below zero" is the operation of this calculation tied to the amount of policyholder dividends paid in any given year. But even then, the section requires that when the differential earnings amount is greater than the amount of policyholder dividends paid by the company that year (which would give a result below zero), the company's reserves are decreased, creating a dollar-for-dollar increase in a mutual company's taxable income. *See* App. 25a; 23a (§ 809(a)(2); § 807(a) & (b)). The calculation of the differential earnings amount is therefore not tied or limited to the amount of the policyholder dividends deduction allowed under Section 808.

The calculation in the second year, the recomputed differential earnings amount, is also independent of the amount of policyholder dividends paid in any given year. Section 809(f) provides a mechanism in which mutual life insurance companies must recompute the differential earnings amount that was included in the previous year's tax.

If, on the one hand, it turns out that the recomputed amount is greater than the original amount, Section 809(f)(1) requires the company to include the excess as "life insurance gross income" for that year, to the tax detriment of the company. It does not matter how much greater the recomputed amount may be; even if the difference is more than the total policyholder dividends paid the previous year, the statute directs that "such excess *shall* be included in life insurance gross income for the succeeding taxable year." App. 30a (§ 809(f)(1)) (emphasis added). Section 809(f)(1) thus imposes a potentially unlimited tax liability on mutual companies.

If, on the other hand, it turns out that the recomputed amount is less than the original amount, then the company is allowed to deduct the difference from that year's taxable income as a "life insurance deduction." *See* App. 30a-31a (§ 809(f)(1) & (2)). Nothing in Section 809(f) limits that deduction or refers to any other provision imposing any such limit.

Nonetheless, the court of appeals ruled that the statute somehow restricts this life insurance deduction to an amount that, when added to the previous year's policyholder dividend deduction, does not exceed the dividends actually paid in that year. To reach this result, however, the court in effect added to Section 809(f)(2) a concluding phrase that does not appear in the statute, namely, "to the extent the sum of the two deductions is not greater than the total amount of policyholder dividends paid the previous year." Changing the meaning of the section in such a drastic and significant way cannot be supported. *See Crooks v. Harrelson*, 282 U.S. 55, 58 (1930) ("to construe the clause as though it said, 'to the payment of charges and expenses, *or either of them*,' as petitioner seems to contend, would be to add a material element to the requirement, and thereby to create, not to expound, a provision of law") (emphasis in original); *United States v. Temple*, 105 U.S. 97, 99 (1882) ("When the language is plain we have no right to insert words and phrases, so as to incorporate in the statute a new and distinct provision.").

Yet that is precisely what the Treasury Department did when it issued regulations after losing this case in the district court. It rewrote Section 809 to include a provision prohibiting the recomputed differential earnings rate from ever being "less than zero." App. 32a (26 C.F.R. § 1.809-9(a)). Such a provision is made up of whole cloth.

The court of appeals' interpretation of Section 809 limits the tax *benefits* of the mathematical formula on the ground that the section is inextricably linked to the amount of policyholder dividends paid in any given

year. Yet at the same time the court properly gives meaning to the Section 809 provisions that increase the tax *liabilities* of mutual companies, even though the language of those provisions unambiguously severs any relationship between Section 809's calculations and the amount of policyholder dividends paid in any given year. It simply makes no sense to read into Section 809 nonexistent language that creates a restrictive relationship between the amount of policyholder dividends paid and the mathematical formulae that estimate earnings in mutual companies, when language in Section 809 provides that such a relationship just does not exist. *See Moore v. United States*, 249 U.S. 487, 489 (1919) ("act of Congress must be read 'according to the natural and obvious import of the language, without resorting to subtle and forced construction for the purpose of either limiting or extending its operation' ") (quoting *United States v. Temple*, 105 U.S. 97, 99 (1882)).

### B. The Court Of Appeals Mistakenly Relied On Section 808 In Interpreting The Otherwise Plain Language Of Section 809.

The other principal ground for the court of appeals' misinterpretation of Section 809 was that Section 808(c) provides for a reduction of the policyholder dividend deduction:

> (c) AMOUNT OF DEDUCTION.—
>
> (1) IN GENERAL.—Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.
>
> (2) REDUCTION IN CASE OF MUTUAL COMPANIES.—In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809.

App. 24a (§ 808(c)). Although the genesis of the statute at issue was Congress' "attempt to isolate the taxable

component of dividends that mutual life insurance companies like AMLI make to their policyholders," App. 2a, the mechanism enacted by Congress in Section 809 was one that was not tied to the amount of policyholder dividends paid in any particular year. In ascribing such overriding importance to Section 808, the court of appeals shoehorned the statute into a narrowly-defined time period. By focusing on a single given year, and ignoring the multi-year approach, the court of appeals misinterpreted Section 809. In light of the structure of the statute, the way the differential earnings rate is defined, and the legislative history, the only sensible interpretation of Section 809 is one that takes the multi-year view.

The structure of the statute confirms that Congress did not provide and did not intend that mutual life insurance companies pay a tax based on a single annual adjustment of the policyholder dividends deduction. Rather, the statute proceeds through a two-step calculation for each year, and each step in that process relies on an average of three prior years' stock earnings rates. The statute is designed to produce its intended result over time, not in a year-by-year snapshot. App. 24a, 30a (§ 809(a) & (f)); *see Interim Report, supra,* at 15 n.2. Although the court of appeals stated that the second year's calculation relates solely to the policyholder dividends paid in the first year, App. 4a, the statute itself differentiates between the two, calling the first-year calculation a policyholder dividend deduction reduction and the second-year calculation a life insurance deduction.

Further support for the proposition that the life insurance deduction taken in the second year is not limited by the amount of policyholder dividends paid, or the amount of the policyholder dividend deduction taken, in the first year is provided by the relevant IRS instructions and forms. According to the instructions to Form 1120L, the first-year "Deductible policyholder dividends," which include the Section 809(a) reduction in the policyholder dividend deduction, are calculated on Schedules E and F, and set forth on line 11 of Schedule A. In contrast, the

second-year "Other deductions," which include Section 809(f)(2) "life insurance deductions," are set forth on line 14 of Schedule A. *See* Form 1120L (1987).

Section 809's reliance on an adjusted three-year industry average of stock life insurance companies' earnings rates for years other than the year in question confirms the statute's intended time frame. App. 27a (§ 809(c)). The very definition of the key variable requires mutual companies to take into account a multi-year view of the relationship between stock company earnings and mutual company earnings to determine the purported earnings portion of mutual policyholder dividends.

The record in the district court contained uncontradicted evidence that limiting total deductions for each year to the amount of dividends paid in that year and preventing the use of a negative recomputed differential earnings rate does not make sense from a statistical point of view. Because the statutory formula compares rolling averages of earnings rates for three prior years for stock companies with the current year's earnings rate for mutual companies, there is no necessary correlation between the formula and the actual differences in earnings rates between mutual companies and stock companies for any given year. Because earnings rates vary from year to year, the use of this multi-year formula causes the rate to be skewed to an artifically high or low level (possibly including negative levels) for individual years. To measure fairly and accurately the difference between the rates, all values in the formula—including the negative values—must be included.

Finally, the legislative history of Section 809 confirms that its intent was to provide a multi-year picture of the earnings portion of any policyholder dividends paid by mutual companies. The Treasury Department's review of the legislative history confirms this: "Congress also believed that mutual and stock companies in the same industry will earn comparable rates of return on equity *over a period of several years.*" *Final Report*, *supra*, at 26. In addition, repeated throughout the legislative his-

tory was the congressional mantra to "level the playing field" between the stock companies and the mutual companies.[8] That playing field, however, cannot be level if it achieves inequitable results. The court of appeals' interpretation produces such inequitable results by limiting the calculation to the amount of policyholder dividends paid in any given year. Indeed, in its Final Report to Congress (which the Tax Reform Act of 1984 required), the Treasury Department acknowledged the inequities that inevitably result from the rule that the recomputed differential earnings rate can never be negative. As the Treasury Department recognized, these inequities only compound the already "inappropriate" mismatching of years involved in the statutory calculation.

> Furthermore, the mismatching is more likely to deny to mutual companies full credit for their earnings in a year in which both segments have unusually high earnings, and the high mutual earnings rate is compared with the lower stock rates of the preceding years. The Internal Revenue Service has ruled that the

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[8] *See* 129 Cong. Rec. S14529 (daily ed. Oct. 25, 1983) (stating purpose to "maintain intra-industry balance between stock and mutual companies") (Sen. Bentsen); *id.* at S14544 (stating goal to "strike a proper balance between the tax burdens on the two major segments of the industry") (Sen. Chafee); Staffs of the Joint Comm. on Taxation and Senate Comm. on Finance, *Major Issues in the Taxation of Life Insurance Products, Policyholders & Companies*, 10-11 (Joint Comm. Print 1983) ("Probably the most important point is that, whatever approach is taken on this issue, the goal is primarily to provide a mechanism for competitive balance between stock and mutual companies which will be dynamic enough to adjust to changes in the industry over time."); *Tax Treatment of Life Insurance, Hearings Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means*, 98th Cong., 1st Sess. 69 (May 10, 11; July 28, 1983) ("The question is how to retain the competitive balance between the stocks and mutuals and at the same time have a just, fair and equitable tax law.") (Rep. Guarini); *id.* at 76 (goal is "to level that playing field between stocks and mutuals") (Chairman Starks); *id.* at 221, 223 (goal is "to create a level playing field") (Rep. Moore); *id.* at 226, 379 (same) (Rep. Dorgan); *id.* at 229 (same) (Rep. Kennelly).

> average mutual earnings rate for any year cannot exceed the imputed stock earnings rate for that year. As a result, part of the mutual company earnings for a high earnings rate year may never be included in the formula of section 809. . . . In other words, a significant portion of mutual company earnings in 1986 will never be taken into account under section 809.

*Final Report, supra,* at 35 (footnote omitted). This is precisely the result ordered by the court of appeals at the urging of the government. To say that Congress intended such a result simply flies in the face of its expressly stated purpose of leveling the playing field. In another tax case, this Court ruled:

> What the Commissioner cannot do—because it is an "unreasonable" interpretation of the statutory language in light of its history and purpose—is to resolve the practical problems by eliminating the allowance altogether. Eliminating the allowance might make the statute "simpler to administer," . . . but it does so by ignoring the language of the statute, the views of those who sought its enactment, and the purpose they articulated.

*Commissioner v. Engle*, 464 U.S. 206, 227 (1984). The government here is trying to eliminate the negative values in the statutory formulae by ignoring the statutory language and the views of those who enacted it. This Court should not permit it to do so.

Moreover, the Treasury Department has also recognized that the underlying theory of Section 809, *i.e.*, that there is an untaxed earnings portion of a mutual company's policyholder dividends, was flawed from the outset, and that, as a result, Section 809 imposes an extra tax on mutual companies. *See Final Report, supra,* at 26-28, 36. Whereas investors in stock life insurance companies provide their companies with a tax-free capital base, a mutual company's policyholder premiums, which are used in the same manner as the stock companies' capital contributions from investors, are subject to a corporate tax imposed at the time those premiums are received. There-

fore, when mutual companies return portions of the premiums to their policyholders as dividends, they are returning money that has already been subject to a tax at the corporate level. Thus, the tax imposed by Section 809 is a double tax on mutual companies; one that is not being paid by stock companies. *Id.* at 26-28. Although the place to right this wrong is obviously in Congress, it is, to put it mildly, undesirable to exacerbate the inequity by interpreting Section 809 in a way that further disadvantages mutual companies.

To the extent that the court of appeals was trying to further the "purpose of the statute[, which] is to reduce mutual companies' deductions by imputing income into dividends that would otherwise be fully deductible," App. 5a, that purpose is served by the district court's and AMLI's reading of the statute. The only question is how much and over what period of time. A multi-year view of Section 809 does limit and reduce mutual companies' dividend deductions over time. Indeed, as the statistics demonstrate, over the first eleven years that the statute has been in effect, AMLI's and the mutual life insurance industry's deductions have been reduced by the operation of Section 809, even when a negative recomputed differential earnings rate is recognized. From 1984 through 1994, AMLI paid approximately $197 million in policyholder dividends. Under AMLI's interpretation of Section 809, AMLI is not allowed to deduct approximately $12.3 million of that amount.[9] In other words, even under AMLI's interpretation, Section 809 has acted as a *deduction reduction* mechanism over time.

Thus AMLI's interpretation of the statute is consistent with the statutory language and furthers not only the

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[9] The government has not yet published the recomputed differential earnings rate for 1994. The 1994 component of the above amount is therefore estimated using figures appearing in a Moody's Investors Service report. *See* Moody's Investors Service, *Moody's Sees Higher Taxes for Mutual Life Insurance Companies Affecting Capital Growth* (April 1995). Under the government's interpretation of Section 809, AMLI is not allowed to deduct approximately $40 million of the $197 million in dividends paid.

purpose stated by Congress (creating a level playing field), but even the purpose the government has sought to attribute to Congress (reducing the policyholder dividend deduction for mutual companies). In contrast, the government's interpretation does violence to the statutory language and ignores at least one purpose of the statute. Petitioner's interpretation is therefore the correct one. *See United States v. Goodyear Tire & Rubber Co.*, 493 U.S. 132, 143-44 (1989). By interpreting the statute consistent with AMLI's view, there are no "inappropriate" results, the Treasury is not looted, and the intent of Congress is followed. Although the court of appeals' interpretation increases revenue for the Treasury, that is not a principled basis for decision, especially when the result is accomplished by inequitable means and in derogation of the congressional intent underlying the statute.

### C. The Court Of Appeals Misinterpreted Section 809's Use Of The Term "Excess."

The court of appeals ruled that "[n]either the recomputed differential earnings rate nor the recomputed differential earnings amount should be negative." App. 7a. In attempting to support this decision, the court reasoned that "Congress . . . assumed that the imputed earnings rate (based upon stock company data) would always exceed the average mutual earnings rate. . . . But whether Congress was right or wrong in its assumption, it expected, and thus intended, that 'excess' would be a positive number." *Id.* In addition, the court stated that the "term excess . . . is more susceptible to a reading as a positive number than as a negative number." *Id.* Both these premises are fundamentally unsound.

First, Congress did not assume that the imputed earnings rate would always exceed the average mutual earnings rate. Instead, it assumed only that *for a given year* the stock companies' earnings rate would exceed the mutual companies' rate. Because the *imputed* earnings rate involves an average of the three previous years of stock company earnings, this congressional assumption, which had support in the statistical data presented to

Congress, can remain valid even accepting AMLI's interpretation of the statute. Therefore, to the extent that the court below believed that the improperly stated assumption mandated the government's interpretation of the statute, it was simply wrong. Moreover, the court of appeals' decision prevents the statute from operating to reduce mutual company tax burdens for years in which prior years' stock company earnings rates are in fact less than the mutual rate for the current year. Such a decision reads into the statute a goal of disadvantaging mutual companies, instead of leveling the playing field.

As to the second rationale given, the use of the term "excess" in various other subsections of Section 809, supports the position that the use of "excess" in subsection (c) allows it to refer to negative numbers. When Congress, in the 1984 legislation, intended the term "excess" to refer only to positive numbers, it specifically provided for the treatment of positive and negative results. For example, subsection 809(a)(1) directs that "the amount of the deduction allowed under section 808 shall be reduced (but not below zero) by the differential earnings amount." App. 24a. Subsection 809(a)(2) then provides that "if the differential earnings amount exceeds the amount allowable as a deduction under section 808 . . ., such *excess* shall be taken into account under subsections (a) and (b) of section 807." App. 24a-25a (emphasis added). "Excess" must be positive there, because subsection 809(a)(1) directs what must be done if there is a negative excess. Again in subsections (f)(1) and (f)(2) of Section 809, Congress used the term "excess", but provided specific instructions as to what is to happen when the number is positive or negative.

In contrast, the subsections that define the recomputed differential earnings rate state that it is "the excess of—(A) the imputed earnings rate for the taxable year, over (B) the average mutual earnings rate" for that year. App. 27a (§ 809(c)(1) & (f)(3)). There are no other definitions of what the rate can be or what happens in various

circumstances. Therefore, the term "excess" as used in this context certainly could refer to both positive and negative results. *See, e.g., Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932) (a word can have different meanings even when used within the same section of a statute).

Moreover, the record is decidedly one-sided for the view that the recomputed DER can be negative. All the experts, including the one hired and paid for by the government, agreed that the rate as written in Section 809 could be negative. Indeed, even the government at the district court level admitted that the calculations in Section 809 could produce negative differential earnings rates. On appeal, the government withdrew its earlier admission and suggested that inexperienced counsel were to blame. The government's position, however, was not the result of a mistake by counsel. Instead, it was the practice and policy of the Treasury Department since the passage of the 1984 statute to read Section 809 as being able to generate negative recomputed differential earnings rates.

Indeed, the Treasury Department admitted that the differential earnings rate and the recomputed differential earnings rate could be negative and actually published the tentative recomputed differential earnings rate for 1986 as —1.700 percent. *See* Announcement 88-47, 1988-12 I.R.B. 56. In its Reports to the Congress, it failed to assert that the word "excess" in the statute meant that the number had to be positive. Instead, it discussed the excess as the "difference between the differential earnings amount and the recomputed differential earnings amount." *Interim Report, supra*, at 5; *Final Report, supra*, at 8. Such use was consistent with the legislative history of the statute, which stated that "when actual data becomes available, any difference beween the average differential earnings amount for the taxable year and the average differential earnings amount for the second preceding year is to be taken into account as an addition to or deduction from income . . . ." S. Rep. No. 169, 98th Cong., 2d Sess.,

Vol. I, 552 (1984). Moreover, even after the Internal Revenue Service announced that the recomputed differential earnings rate could never be negative, it continued to announce that it had calculated other negative rates under Section 809. *See* note 6 *supra*.

Petitioner's position that "excess" can be negative in Section 809, therefore, is not a taxpayer's strained attempt to capitalize on some loophole in the Internal Revenue Code. Instead, that reading was the interpretation of the Department of the Treasury until it decided that such an interpretation was detrimental to its litigating position in this lawsuit. The government's argument, accepted by the court of appeals, that the recomputed differential earnings rate can never be negative therefore must be taken with some salt. Nothing in the language of Section 809 requires this result.

## II. THE PETITION SHOULD BE GRANTED BECAUSE IT WILL SAVE JUDICIAL RESOURCES TO RESOLVE THE ISSUE NOW.

In the court below, the government recognized the immense importance of this issue, requesting extensions of time and expanded page limits due to the question's significance. *See* Declaration of Edward T. Perelmuter, ¶ 2 (June 24, 1994) (filed in support of Appellant's Motion to Exceed Page Limits); Unopposed Motion for Extension of Time for Filing Appellant's Reply Brief, ¶ 1 (June 24, 1994). Because of the issue's overriding importance to the administration of the federal tax laws, review is warranted on that ground alone. *See, e.g., United States v. Goodyear Tire & Rubber Co.*, 493 U.S. 132, 138 (1989) (granting certiorari to "clarify the operation of the § 902 credit in the tax years to which it applies"); *Harrison v. Northern Trust Co.*, 317 U.S. 476, 478 (1943) (granting certiorari "because of the importance of the question in the administration of the federal estate tax system").

In addition, this case is of extreme importance due to the staggering amount of money involved. The government itself estimates that the ruling it won in the court of

appeals will cost the mutual life insurance industry 5 *billion* dollars. *See* Department of Justice Press Release, *Tax Attorney Received the John Marshall Award for Saving Tax Payers Five Billion Dollars* (June 22, 1995). For that reason alone, this Court should grant certiorari. *See, e.g., United States v. Hill*, —— U.S. ——, 113 S. Ct. 941, 945 (1993) ("Because of the importance of the issue to the federal fisc, we granted certiorari."). This ruling will also adversely affect the more than 100 million mutual policyholders and beneficiaries.

Moreover, this is not an issue that will await some sort of legislative correction. Although large insurance companies are able to keep their tax returns open for many years while all issues are resolved, smaller companies, like AMLI, must close their returns. Therefore, many companies have closed or are closing their books with regard to the 1986 tax year and the years thereafter. To prevent the statute of limitations from running, these smaller companies will need to file lawsuits against the United States to preserve this issue. As a result, the federal courts will face numerous lawsuits, all involving this one issue of statutory interpretation. Because the stakes are so high, this issue can be expected to be litigated by mutual insurance companies in many, if not all federal circuits. The court of appeals' decision will be binding only in the Eighth Circuit. The lawsuits will not end until this Court has definitively ruled.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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July 19, 1995

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# APPENDICES

**APPENDIX A**

UNITED STATES COURT OF APPEALS
EIGHTH CIRCUIT

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No. 94-1440

AMERICAN MUTUAL LIFE INSURANCE COMPANY and SUBSIDIARIES,
*Appellee,*

v.

UNITED STATES OF AMERICA,
*Appellant,*

THE STOCK COMPANY INFORMATION GROUP,
*Amicus Curiae.*

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Submitted Oct. 10, 1994

Decided Dec. 15, 1994

Rehearing and Suggestion for Rehearing En Banc
Denied March 21, 1995 *

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Before MAGILL, Circuit Judge, HEANEY, Senior Circuit Judge, and MORRIS SHEPPARD ARNOLD, Circuit Judge.

MORRIS SHEPPARD ARNOLD, Circuit Judge.

The issue in this case is whether Congress intended to give mutual life insurance companies so-called dividend

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* Hansen, Circuit Judge, took no part in the consideration or decision of this case.

deductions greater than their dividends in any given year. The court concludes that Congress did not so intend, and therefore reverses the judgment of the district court.

## I.

Appellee American Mutual Life Insurance ("AMLI") is a mutual life insurance company. AMLI sued the government for a tax refund, claiming that the Internal Revenue Service improperly calculated its income deductions for the year 1986. The district court granted summary judgment to AMLI, concluding that the statute allowed AMLI the full amount of the deductions it claimed. The government has appealed, asserting that the district court's reading of 26 U.S.C. § 809 violates congressional intent.

Section 809 is an attempt to isolate the taxable component of dividends that mutual life insurance companies like AMLI make to their policyholders. Mutual life insurance companies make dividends to their policyholders that contain both taxable and untaxable components. The taxable component is the distribution of earnings to owners; the untaxable component consists of price rebates to customers. The dividend that mutual life insurance policyholders receive is not easily broken into its components because mutual life insurance companies do not have separate groups of stockholder owners and policy-holding customers. The customers own the company. By contrast, stock life insurance companies pay earnings to stockholders as nondeductible dividends, and refunds to their insurance policyholders as deductible price rebates.

Section 809 is thus designed to identify the taxable component of mutual life insurance company dividends. It imputes income to mutual life insurance companies based on actual rates of return on equity experienced by stock companies, and requires mutual life insurance com-

panies to reduce their deductions to reflect an imputed distribution of earnings to their policyholders.

Section 809 requires a comparison between an imputed stock company rate of return before the payment of stockholder dividends (the "imputed earnings rate"), and a mutual company rate of return after the payment of policyholder dividends (the "average mutual earnings rate"). Section 809(c)(1), (d), (e). The mutual company rate of return is based on two-year-old data. Congress theorized that the difference between these two rates was attributable to equity returns distributed to mutual company policyholders and that the difference provided a basis on which to adjust the income of mutual life insurance companies. The excess of the imputed earnings rate over the average mutual earnings rate produces a "differential earnings rate" which is multiplied times the individual company's average equity base for the year to produce a "differential earnings amount." Section 809(a)(3), (b)(1), (c)(1). This amount represents the earnings component of the mutual company's dividend. The mutual company then reduces its policyholder dividends deduction by the differential earnings amount. Sections 808(c)(2), 809(a)(1).

Second 809 is quite complex, not only because it relies upon numerous calculations, but because it relies in part on an average of the earnings rate of mutual companies for the taxable year, a figure that is not available until a year after that the tax is due. As a result, section 809 requires two computations in each of two tax years: the first is made the year the tax is due, and the second is made the following year. The first makes a preliminary calculation of the deduction based on average mutual company earnings data from two years before. *See supra.* In the second calculation, a "recomputed differential earnings rate" and a "recomputed differential earnings amount" are calculated based on the difference between the imputed earnings rate for the prior year and the average

mutual earnings rate for the prior year. Section 809(c)(1), (f)(3). If the differential earnings amount exceeds the recomputed differential earnings amount, the excess is allowed as a "life insurance deduction" in the following year. Section 809(f)(2).

We stress that the recalculation is merely a means of achieving a result that was not possible to calculate in the tax year. The first calculation represents the method by which Congress intended to tax mutual life insurance companies; the second calculation is merely a housekeeping measure to reflect the updated data.

II.

The tax year in question is 1986. On its federal income tax return for 1986, AMLI reported a 1986 differential earnings amount of $9,826,925. AMLI arrived at this figure by multiplying the 1986 differential earnings rate of 10.539 percent by plaintiff's 1986 average equity base of $93,243,430. The 1986 differential earnings rate was reckoned as the difference between the 1986 imputed earnings rate (16.285%) and the 1984 average mutual earnings rate (5.746%). Pursuant to sections 808(c)(2) and 809(a)(1), AMLI reduced its policyholder dividends deduction for 1986 by the differential earnings amount, from $13,985,737 to $4,158,812. These figures are not in dispute.

The following figures are in dispute. For the subsequent tax year, 1987, AMLI claims a 1986 recomputed differential earnings amount of *minus* $1,580,476. AMLI arrived at this figure by multiplying the 1986 "recomputed differential earnings rate" of —1.695% by AMLI's 1986 average equity base of $93,243,430. AMLI calculated the 1986 recomputed differential earnings rate as the 1986 imputed earnings rate (16.285%) minus the 1986 average mutual earnings rate (17.980%). AMLI therefore claims a life insurance deduction for 1987 of $11,407,401, the 1986 differential earnings amount of

$9,826,925 minus the 1986 recomputed differential earnings amount of negative $1,580,476.

The government denies that AMLI is entitled to subtract the negative $1,580,476 because this will give AMLI deductions greater than its dividends. According to the government, neither the recomputed earnings rate nor the recomputed differential earnings amount can be negative. Thus, AMLI's life insurance deduction for 1987 should be $9,826,925. The government argues that AMLI is attempting to obtain a tax windfall because, while its 1986 dividends are $13,985,737, it is claiming total deductions of $15,566,213 for 1986 ($4,158,812 taken in 1986 and $11,407,401 taken in 1987).

III.

A review of the statute and its legislative history suggests that AMLI is not entitled to deduct an amount greater than its dividends.

1. The purpose of the statute is to reduce mutual companies' deductions by imputing income into dividends that would otherwise be fully deductible. The title of section 809 reflects this purpose: "Reduction in certain deductions of mutual life insurance companies." So does the legislative history. *See* H.R.Rep. No. 432, 98th Cong., pt. 2, at 1422, *reprinted in* 1984 U.S.C.C.A.N. 697, 1067. In addition, section 808 provides that, regarding mutual companies in particular, "the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809." Section 808(c)(2). AMLI's position is that it is entitled to a deduction *enhancement*. The statute and the legislative history suggest otherwise.

2. The statute specifically limits the deduction for policyholder dividends for any taxable year to an amount equal to the policyholder dividends paid or accrued during the taxable year. For mutual companies, this amount should be further reduced according to section 809.

(c) Amount of deduction.—

(1) In general.—Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.

(2) Reduction in case of mutual companies.—In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809.

Section 808(c). AMLI's reading of the statute increases its deductions to an amount greater than its dividends for the 1986 tax year. The district court believed that section 808(c) did not apply to limit section 809(f), because the recalculation set forth in section 809(f) was a "life insurance deduction" rather than a deduction for a "policyholder dividend." The district court believed that the 809(f) recalculation was a separate "other deduction" allowed under the catch-all provision of section 805(a)(8).

There is no material distinction between "life insurance deduction" and "policyholder dividend deduction" under the facts of this case. Under section 804, "life insurance deductions" are the general deductions available in section 805. Section 805 provides for several kinds of life insurance deductions, including policyholder dividends that have been calculated under section 808 (c), but specifically provides that "[e]xcept as provided in paragraph (3), no amount shall be allowed as a deduction under this part in respect of policyholder dividends." The 809(f) recalculation simply modifies the section 809 policyholder deduction that was calculated in the prior year, and functions as an adjustment "in respect of policyholder dividends." Hence, the requirements of section 808(c) must apply to section 809.

3. Neither the recomputed differential earnings rate nor the recomputed differential earnings amount should be negative. The negative recomputed differential earnings amount arises here because of the recalculation of the differential earnings rate under 809(c)(1) and (f)(3). The recalculated rate is defined as the "excess" of the imputed earnings rate for the taxable year "over" the average mutual earnings rate for the taxable year. For the tax year 1986, this rate turned out to be negative. AMLI argues that the statute allows for a negative "excess." Indeed, in past years, the Internal Revenue Service acknowledged the possibility of a negative excess.

Congress, however, assumed that the imputed earnings rate (based upon stock company data) would always exceed the average mutual earnings rate. In designing section 809, Congress "determined that the average pretax return on equity of mutual companies falls below that for a comparable group of stock companies." H.R. Rep. No. 432, 98th Cong., pt. 2, at 1422, *reprinted in* 1984 U.S.C.C.A.N. 697, 1067. This is the operative assumption behind the section 809 formula. It turned out to be wrong in 1986 (and, according to the parties, several succeeding years as well). But whether Congress was right or wrong in its assumption, it expected, and thus intended, that "excess" would be a positive number.

The term "excess," moreover, is more susceptible to a reading as a positive number than as a negative number. The statute states that the desired figure is the "excess" of A "over" B. This is the same as asking for the amount by which A exceeds B. If B is greater than A, there is no excess, and the amount by which A exceeds B is zero. AMLI's argument that the concept of "negative excess" has some specialized industry meaning, and that Congress intended that "excess" carry this meaning in section 809, is not convincing. "Language used in tax statutes should be read in the ordinary and natural sense." *Helvering v. San Joaquin Co.*, 297 U.S. 496, 499, 56 S.Ct. 569, 570,

80 L.Ed. 824 (1936). Section 809, moreover, for the reasons already explained, did not anticipate a "negative excess."

4. AMLI asserts that section 809(f) reflects a statistical formula under which mutuals are overtaxed in some years and undertaxed in others. AMLI maintains that Congress envisioned a scheme in which the mutuals' deductions even out in the long run, even if the deductions in any one year are greater than the dividends, because mutuals' deductions are less than the dividends in other years. AMLI points to the rolling three-year average of stock company data used to calculate the imputed stock rate as evidence that this was the congressional intent. This is an intriguing theory, but there is no evidence that this was what Congress had in mind. Rather, it seems more likely that section 809(f) reflects nothing more than a method of evening-up the prior year's incomplete data. *See* H.R.Rep. No. 432, 98th Cong., pt. 2, at 1425, *reprinted in* 1984 U.S.C.C.A.N. 697, 1070. There is no indication whatsoever that it serves any greater purpose as a statistical calculation of earnings trends over time in the life insurance industry. *See id.*

5. After the district court issued its decision, the Internal Revenue Service issued regulations stating that neither the differential earnings rate under section 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under section 809(f)(3) may be less than zero. The regulation is effective for all taxable years beginning after December 31, 1986. *See* 26 C.F.R. § 1.809-9. For the reasons already outlined, this regulation is a reasonable interpretation of the statute. Treasury regulations are entitled to great deference, and must be sustained unless unreasonable and plainly inconsistent with the revenue statutes. *Commissioner v. Portland Cement Company of Utah*, 450 U.S. 156, 169, 101 S.Ct. 1037, 1045,

67 L.Ed.2d 140 (1981). While AMLI objects to the government's reliance on a regulation promulgated since the district court's decision, disregarding the regulation would have availed AMLI nothing. The court's conclusion would have been the same, for the regulation embodies the proper interpretation of the statute.

IV.

For the foregoing reasons, the judgment below is reversed.

**APPENDIX B**

[Filed Nov. 2, 1993]

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

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Civil No. 4-92-70347

AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,
*Plaintiff,*

v.

UNITED STATES OF AMERICA,
*Defendant.*

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## MEMORANDUM OPINION AND RULINGS

Plaintiff American Mutual Life Insurance Company brings suit for refund of taxes, claiming the Internal Revenue Service has improperly calculated an adjustment to its income under section 809(f)(2) of the Internal Revenue Code. Both parties have moved for summary judgment. The material facts are undisputed, so there is no genuine issue as to any material fact.

Fed. R. Civ. P. 56(c) provides in part: "The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."

## UNDISPUTED FACTS

Plaintiff is a mutual life insurance company that writes individual and group life and health insurance policies. It is a calendar year basis taxpayer. The Internal Revenue Code requires such a company to adjust its income each year under provisions designed to tax mutual life insurance companies on a basis similar to that on which stock life insurance companies are taxed.

Stock life insurance companies pay equity returns to shareholders as nondeductible dividends, and dividends to policyholders that are fully deductible as private rebates. Mutual life insurance companies do not have shareholders but only policyholders. Based on the theory that mutual company policyholder dividends include both an equity return and a price rebate, Congress enacted section 809 to place stock and mutual life insurance companies on a comparable footing with respect to the payment of equity returns.

Section 809 requires a comparison between an imputed stock company rate of return before the payment of shareholder dividends (the "imputed earnings rate") and a mutual company rate of return after the payment of policyholder dividends (the "average mutual earnings rate"). Congress assumed that the difference between these two rates was attributable to equity returns distributed to mutual company policyholders and that such difference provided a basis on which to adjust the income of mutual life insurance companies. H.R. Rep. No. 432, 98th Cong., 2d Sess., pt. 2, at 1422 (1984); S. Rep. No. 169, 98th Cong., 2d Sess., Vol. I, at 548-49 (1984).

Section 809 requires two computations. In the first of these, under section 809(c), a "differential earnings rate" is computed for each year (*e.g.*, 1986 in this case) based on the difference between the imputed earnings rate for the year (1986) and the average mutual earnings rate for the second preceding year (1984). This rate is multiplied

by a mutual company's "average equity base" for the year (1986) to produce a "differential earnings amount." Under sections 808(c)(2) and 809(a)(1), this amount affects taxable income for the year (1986) by adjusting the section 808 policyholder dividends deduction (and, if the differential earnings amount is greater than the policyholder dividends paid, by adjusting the closing balance of reserves pursuant to section 809(a)(2)).

In the second computation, under section 809(f)(3), a "recomputed differential earnings rate" and a "recomputed differential earnings amount" are computed for the following year (1987) based on the difference between the imputed earnings rate for the prior year (1986) and the average mutual earnings rate for the prior year (1986). The recomputed differential earnings amount (for 1986) is compared to the differential earnings amount (for 1986) and, as relevant here, under section 809(f)(2), the excess of the latter over the former is allowed as a "life insurance deduction" in the following year (1987).

Additional complexity results from the fact that section 809 requires a comparison of stock and mutual earnings rates for different years. Thus, while the average mutual earnings rate for a year (*e.g.*, 1986) reflects mutual company rates of return for that year, the imputed earnings rate for that same year is instead based upon an average of stock company rates of return for the three immediately preceding years (1983, 1984 and 1985).[1]

---

[1] Under section 809(d)(1)(B), the imputed earnings rate for a year equals the average of the stock earnings rates for the three preceding years times the ratio of 16.5 percent to the average of the stock earnings rates for the years 1981, 1982, and 1983. In Revenue Ruling 86-114, 1987-2 C.B. 96, the Internal Revenue Service announced its determination that the average of the stock earnings rates for the years 1981, 1982, and 1983 is 18.221 percent. Accordingly, the formula specified by the statute produces a ratio of 90.55 percent.

On its federal income tax return for 1986, plaintiff reported a 1986 differential earnings amount of $9,826,925.[2] Pursuant to sections 808(c)(2) and 809(a)(1), plaintiff reduced its section 808 policyholder dividends deduction for 1986 by that differential earnings amount, from $13,985,737 to $4,158,812. This computation is not in dispute.

For 1987, plaintiff claims a 1986 recomputed differential earnings amount of *minus* $1,580,476.[3] Relying on section 809(f)(2), plaintiff claims a life insurance deduction for 1987 of $11,407,401, calculated as the difference between the 1986 differential earnings amount of $9,826,925 and the 1986 recomputed differential earnings amount of —$1,580,476.

Plaintiff reported a net operating loss for the 1987 tax year that it carried back to 1984 and made a tentative claim for refund under IRC § 6411 for that year, which was granted by the Internal Revenue Service.

On July 3, 1991, subsequent to an examination by the Internal Revenue Service, a delegate of the Secretary of the Treasury assessed corporate income tax deficiencies against plaintiff relative to the 1984 tax year in the amounts of $580,865 and $164,220, which represent assessed tax and interest respectively. These amounts were fully paid to the United States by plaintiff.

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[2] The 1986 differential earnings amount was calculated by multiplying the 1986 "differential earnings rate" of 10.539 percent by plaintiff's 1986 "average equity base" of $93,243,430. The 1986 differential earnings rate was calculated as the difference between the 1986 imputed earnings rate (16.285 percent) and the 1984 average mutual earnings rate (5.746 percent).

[3] The 1986 recomputed differential earnings amount was calculated by multiplying the 1986 "recomputed differential earnings rate" of −1.695 percent by plaintiff's 1986 average equity base of $93,243,430. The 1986 recomputed differential earnings rate was calculated as the difference between the 1986 imputed earnings rate (16.285 percent) and the 1986 average mutual earnings rate (17.980 percent).

On September 27, 1991, plaintiff filed a claim for refund relative to the taxable year 1984 seeking $729,163 in tax, plus assessed and statutory interest. This claim for refund was denied by the Internal Revenue Service and resulted in this lawsuit. Subsequent to the filing of this lawsuit, plaintiff revised its claim for refund downward to the amount of $668,857 plus assessed and statutory interest.

**The Issue**

The Internal Revenue Service denies $1,580,476 of plaintiff's 1987 life insurance deduction, asserting that the deduction must be limited to plaintiff's 1986 differential earnings amount of $9,826,925, *i.e.*, the amount by which plaintiff reduced its section 808 policyholder dividends deduction for 1986. Plaintiff claims entitlement to the full amount of the $11,407,401 life insurance deduction that it computed under section 809(f)(2) for 1987.

## DISCUSSION

The parties are in agreement that the formula contained in section 809(c)(1) and 809(f)(3) yields a 1986 recomputed differential earnings rate of —1.695 percent and, in turn, a 1986 recomputed differential earnings amount of —$1,580,476.[4] Plaintiff contends that, from this, it necessarily follows under the statute that it is entitled to deduct $11,407,401 for 1987 under section 809(f)(2).

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[4] In Announcement 88-47, 1988-12 I.R.B. 56, the Internal Revenue Service announced its decision that the 1986 recomputed differential earnings rate, based on a tentative data compilation, was "—1.700" percent. In Proposed Treasury Decision FI-159-84, 57 Fed. Reg. 37,495 (1992), citing its prior Notice 88-106, 1988-2 C.B. 444, the Internal Revenue Service stated that it considered the 1986 recomputed differential earnings rate to be zero, "even though the calculated rate was negative." In its briefs in this case, and at oral argument, defendant conceded that the formula contained in section 809(c)(1) and 809(f)(3) produces a negative 1986 recomputed differential earnings rate and a negative 1986 recomputed differential earnings amount.

Section 809(f)(2) provides that where

> (A) the differential earnings amount determined under this section for any taxable year, exceeds
>
> (B) the recomputed differential earnings amount for such taxable year,
>
> such excess shall be allowed as a life insurance deduction for the succeeding taxable year.

Here, the 1986 differential earnings amount of $9,826,925 exceeds the 1986 recomputed differential earnings amount of —$1,580,476 by $11,407,401. The language of section 809(f)(2) provides that "such excess shall be allowed as a life insurance deduction" for 1987. This language on its face unambiguously provides for a life insurance deduction of $11,407,401.

Defendant contends, however, that section 808(c) should be read together with section 809(f)(2), and that the former provision limits the deduction otherwise allowable under the latter. Section 808(c) provides as follows:

> (c) AMOUNT OF DEDUCTION.—
>
> (1) IN GENERAL.—Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.
>
> (2) REDUCTION IN CASE OF MUTUAL COMPANIES.—In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be *reduced* by the amount determined under section 809. [Emphasis supplied.]

According to defendant, section 808(c)(2), due to its use of the word "reduced," prevents a negative differential earnings amount from increasing the policyholder

dividends deduction for one year, and also, by implication, limits the section 809(f)(2) deduction for the following year to the amount of the prior year's differential earnings amount.

Defendant's assertion that section 808(c) should be read into section 809(f)(2), however, disregards the statutory language. The section 809(f)(2) "life insurance deduction" at issue in this case is not a section 808 deduction for policyholder dividends allowable under section 805(a)(3), but, rather, is one of the "other deductions" allowable under section 805(a)(8). Thus, even if, as defendant contends, section 808(c) were to operate to impose a limitation on the amount of policyholder dividends deductible, that provision would not operate to limit the amount of the section 809(f)(2) deduction here at issue.[5] To read section 808(c) into section 809(f)(2), as defendant asks the court to do, would effectively rewrite the statute. It is for Congress, not the courts, to rewrite statutes.

If Congress had intended that the section 809(f)(2) life insurance deduction be limited by section 808(c), it could have expressly qualified section 809(f)(2) to achieve that result. For example, Congress could have added to the provision the final clause, "but the amount of such deduction for the year shall not exceed the differential earnings amount for the preceding taxable year." The statutory language, however, contains no limitation on the amount deductible under section 809(f)(2). The legislative history also indicates that no limitation was intended, providing that "any difference" between the differential earnings amount and the recomputed differential earnings amount is allowable as a life insurance deduction. H.R. Rep. No. 432, *supra*, at 1425; S. Rep. No. 169, *supra*, at 552.

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[5] This case does not involve a deduction for policyholder dividends and, thus, whether section 808(c) prevents recognition of a negative differential earnings amount is not before the court.

The court finds defendant's "whole law" argument and its argument that Congress intended to raise a certain amount of revenue from mutual and stock life insurance companies for the years 1984 through 1988 unpersuasive.

The court concludes that plaintiff is entitled to deduct $11,407,401 as a section 809(f)(2) life insurance deduction for 1987, rather than the $9,826,925 already allowed by defendant.

**RULINGS**

The motion for summary judgment filed by plaintiff on March 31, 1993, is **GRANTED.**

The motion for summary judgment filed by defendant on April 1, 1993, is **DENIED.**

Counsel for plaintiff is directed to promptly submit a proposed order for judgment.

**DATED** this 2nd day of November, 1993.

/s/ Harold D. Vietor
HAROLD D. VIETOR
United States District Judge

## APPENDIX C

[Filed Dec. 9, 1993]

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

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Case Number: 4-92-cv-70347

AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,
*Plaintiff*

v.

UNITED STATES OF AMERICA,
*Defendant.*

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## AMENDED JUDGMENT IN CIVIL CASE

— **JURY** Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

X **Decision by Court.** This action came to consideration before the Court. The issues have been considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED:

Judgment is entered in favor of the plaintiff, American Mutual Life Insurance Company and Subsidiaries, and against the defendant, the United States of America, in the amount of Six Hundred Sixty-Eight Thousand Eight Hundred Fifty-Seven Dollars ($668,857.00) of tax and One Hundred Sixty-Four Thousand Two Hundred Twenty

Dollars and Eighty-Seven Cents ($164,220.87) of interest paid, plus statutory interest thereon according to law.

Date December 9, 1993

JAMES R. ROSENBAUM
Clerk

/s/ [Illegible]
(By) Deputy Clerk

**APPENDIX D**

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

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No. 94-1440SIDM

AMERICAN MUTUAL LIFE INSURANCE COMPANY
AND SUBSIDIARIES,
*Appellee,*

VS.

UNITED STATES OF AMERICA,
*Appellant.*

THE STOCK COMPANY INFORMATION GROUP,
*Amicus Curiae.*

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Appeal from the United States District Court
for the Southern District of Iowa

The suggestion for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

Judge Hansen took no part in the consideration or decision of this case.

March 21, 1995

Order Entered at the Direction of the Court:

/s/ Michael E. Gans
Clerk
U.S. Court of Appeals
Eighth Circuit

## APPENDIX E

## STATUTORY APPENDIX

INTERNAL REVENUE CODE OF 1986 (26 U.S.C.):

### § 801. TAX IMPOSED.

(a) TAX IMPOSED.—

(1) IN GENERAL.—A tax is hereby imposed for each taxable year on the life insurance company taxable income of every life insurance company. Such tax shall consist of a tax computed as provided in section 11 as though the life insurance company taxable income were the taxable income referred to in section 11.

* * * *

(b) LIFE INSURANCE COMPANY TAXABLE INCOME.—For purposes of this part, the term "life insurance company taxable income" means—

(1) life insurance gross income, reduced by

(2) life insurance deductions.

* * * *

### § 803. LIFE INSURANCE GROSS INCOME.

(a) IN GENERAL.—For purposes of this part, the term "life insurance gross income" means the sum of the following amounts:

(1) PREMIUMS.—

(A) The gross amount of premiums and other consideration on insurance and annuity contracts, less

(B) return premiums, and premiums and other consideration arising out of indemnity reinsurance.

(2) DECREASES IN CERTAIN RESERVES.—Each net decrease in reserves which is required by section 807(a) to be taken into account under this paragraph.

(3) OTHER AMOUNTS.—All amounts not includible under paragraph (1) or (2) which under this subtitle are includible in gross income.

* * * *

**§ 804. LIFE INSURANCE DEDUCTIONS.**

For purposes of this part, the term "life insurance deductions" means—

(1) the general deductions provided in section 805, and

(2) the small life insurance company deduction (if any) determined under section 806(a) . . .

* * * *

**§ 805. GENERAL DEDUCTIONS.**

(a) GENERAL RULE.—For purposes of this part, there shall be allowed the following deductions:

* * * *

(2) INCREASES IN CERTAIN RESERVES.—The net increase in reserves which is required by section 807(b) to be taken into account under this paragraph.

(3) POLICYHOLDER DIVIDENDS.—The deduction for policyholder dividends (determined under section 808(c)).

* * * *

(8) OTHER DEDUCTIONS.—Subject to the modifications provided by subsection (b), all other deductions allowed under this subtitle for purposes of computing taxable income.

Except as provided in paragraph (3), no amount shall be allowed as a deduction under this part in respect of policyholder dividends.

## § 807. RULES FOR CERTAIN RESERVES.

(a) DECREASE TREATED AS GROSS INCOME.—If for any taxable year—

(1) the opening balance for the items described in subsection (c), exceeds

(2)(A) the closing balance for such items, reduced by

(B) the sum of (i) the amount of the policyholders' share of tax-exempt interest, plus (ii) any excess described in section 809(a)(2) for the taxable year,

such excess shall be included in gross income under section 803(a)(2).

(b) INCREASE TREATED AS DEDUCTION.—If for any taxable year—

(1)(A) the closing balance for the items described in subsection (c), reduced by

(B) the sum of (i) the amount of the policyholders' share of tax-exempt interest, plus (ii) any excess described in section 809(a)(2) for the taxable year, exceeds

(2) the opening balance for such items,

such excess shall be taken into account as a deduction under section 805(a)(2).

* * * *

## § 808. POLICYHOLDER DIVIDENDS DEDUCTION.

(a) POLICYHOLDER DIVIDEND DEFINED.—For purposes of this part, the term "policyholder dividend" means any dividend or similar distribution to policyholders in their capacity as such.

(b) CERTAIN AMOUNTS INCLUDED.—For purposes of this part, the term "policyholder dividend" includes—

(1) any amount paid or credited (including as an increase in benefits) where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management,

(2) excess interest,

(3) premium adjustments, and

(4) experience-related refunds.

(c) AMOUNT OF DEDUCTION.—

(1) IN GENERAL.—Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.

(2) REDUCTION IN CASE OF MUTUAL COMPANIES.—In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809.

* * * *

## § 809. REDUCTION IN CERTAIN DEDUCTIONS OF MUTUAL LIFE INSURANCE COMPANIES.

(a) GENERAL RULE.—

(1) POLICYHOLDER DIVIDENDS.—In the case of any mutual life insurance company, the amount of the deduction allowed under section 808 shall be reduced (but not below zero) by the differential earnings amount.

(2) REDUCTION IN RESERVE DEDUCTION IN CERTAIN CASES.—In the case of any mutual life insurance company, if the differential earnings amount exceeds the amount allowable as a deduction under section 808 for the taxable year (determined without regard

to this section), such excess shall be taken into account under subsections (a) and (b) of section 807.

(3) DIFFERENTIAL EARNINGS AMOUNT.—For purposes of this section, the term "differential earnings amount" means, with respect to any taxable year, an amount equal to the product of—

(A) the life insurance company's average equity base for the taxable year, multiplied by

(B) the differential earnings rate for such taxable year.

(b) AVERAGE EQUITY BASE. For purposes of this section—

(1) IN GENERAL.—The term "average equity base" means, with respect to any taxable year, the average of—

(A) the equity base determined as of the close of the taxable year, and

(B) the equity base determined as of the close of the preceding taxable year.

(2) EQUITY BASE.—The term "equity base" means an amount determined in the manner prescribed by regulations equal to—

(A) the surplus and capital,

(B) adjusted as provided in paragraphs (3), (4), (5), and (6) of this subsection.

No item shall be taken into account more than once in determining equity base.

(3) INCREASE FOR NONADMITTED FINANCIAL ASSETS.—

(A) IN GENERAL.—The amount of the surplus and capital shall be increased by the amount of the nonadmitted financial assets.

(B) NONADMITTED FINANCIAL ASSETS.—For purposes of subparagraph (A), the term "nonadmitted financial asset" means any nonadmitted asset of the company which is—

(i) a bond,

(ii) stock,

(iii) real estate,

(iv) a mortgage loan on real estate, or

(v) any other invested asset.

(4) INCREASE WHERE STATUTORY RESERVES EXCEED TAX RESERVES.—

(A) IN GENERAL.—If—

(i) the aggregate amount of statutory reserves, exceeds

(ii) the aggregate amount of tax reserves, the amount of the surplus and capital shall be increased by the amount of such excess.

(B) DEFINITIONS.—For purposes of this paragraph—

(i) STATUTORY RESERVES.—The term "statutory reserves" means the aggregate amount set forth in the annual statement with respect to items described in section 807(c). Such term shall not include any reserve attributable to a deferred and uncollected premium if the establishment of such reserve is not permitted under section 811(c).

(ii) TAX RESERVES.—The term "tax reserves" means the aggregate of the items

described in section 807(c) as determined for purposes of section 807.

(5) INCREASE BY AMOUNT OF CERTAIN OTHER RESERVES.—The amount of the surplus and capital shall be increased by the sum of—

(A) the amount of any mandatory securities valuation reserve,

(B) the amount of any deficiency reserve, and

(C) the amount of any voluntary reserve or similar liability not described in subparagraph (A) or (B).

(6) ADJUSTMENT FOR NEXT YEAR'S POLICYHOLDER DIVIDENDS.—The amount of the surplus and capital shall be increased by 50 percent of the amount of any provision for policyholder dividends (or other similar liability) payable in the following taxable year.

(c) DIFFERENTIAL EARNINGS RATE.—

(1) IN GENERAL.—For purposes of this section, the differential earnings rate for any taxable year is the excess of—

(A) the imputed earnings rate for the taxable year, over

(B) the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

(2) TRANSITIONAL RULE.—The differential earnings rate—

(A) for any taxable year beginning in 1984, or

(B) for purposes of computing the amount of underpayment under section 6655 (includ-

ing the application of section 6655(d)(3)) for any taxable year beginning in 1985,

shall be equal to 7.8 percent.

(3) COORDINATION WITH ESTIMATED TAX PAYMENTS.—For purposes of applying section 6655 with respect to any installment of estimated tax, the amount of tax shall be determined by using the lesser of—

(A) the differential earnings rate of the second tax year preceding the taxable year for which the installment is made, or

(B) the differential earnings rate for the taxable year for which the installment is made.

(d) IMPUTED EARNINGS RATE.—

(1) IN GENERAL.—For purposes of this section, the imputed earnings rate for any taxable year is—

(A) 16.5 percent in the case of taxable years beginning in 1984, and

(B) in the case of taxable years beginning after 1984, an amount which bears the same ratio to 16.5 percent as the current stock earnings rate for the taxable year bears to the base period stock earnings rate.

(2) CURRENT STOCK EARNINGS RATE.—For purposes of this subsection, the term "current stock earnings rate" means, with respect to any taxable year, the average of the stock earnings rates determined under paragraph (4) for the 3 calendar years preceding the calendar year in which the taxable year begins.

(3) BASE PERIOD STOCK EARNINGS RATE.—For purposes of this subsection, the base period stock earnings rate is the average of the stock earnings

rates determined under paragraph (4) for calendar years 1981, 1982, and 1983.

(4) STOCK EARNINGS RATE.—

(A) IN GENERAL.—For purposes of this subsection, the stock earnings rate for any calendar year is the numerical average of the earnings rates of the 50 largest stock companies.

(B) EARNINGS RATE.—For purposes of subparagraph (A), the earnings rate of any stock company is the percentage (determined by the Secretary) which—

(i) the statement gain or loss from operations for the calendar year of such company, is of

(ii) such company's average equity base for such year.

(C) 50 LARGEST STOCK COMPANIES.—For purposes of this paragraph, the term "50 largest stock companies" means a group (as determined by the Secretary) of stock life insurance companies which consists of the 50 largest domestic stock life insurance companies which are subject to tax under this part. The Secretary—

(i) shall, for purposes of determining the base period stock earnings rate, exclude from the group determined under the preceding sentence any company which had a negative equity base at any time during 1981, 1982, or 1983,

(ii) shall exclude from such group for any calendar year any company which has a negative equity base, and

(iii) may by regulations exclude any other company which otherwise would

have been included in such group if the inclusion of the excluded company or companies would, by reason of the small equity base of such company, seriously distort the stock earnings rate.

The aggregate number of companies excluded by the Secretary under clause (iii) shall not exceed the excess of 2 over the number of companies excluded under clause (ii).

(D) TREATMENT OF AFFILIATED GROUPS.—For purposes of this paragraph, all stock life insurance companies which are members of the same affiliated group shall be treated as one stock life insurance company.

(e) AVERAGE MUTUAL EARNINGS RATE.—For purposes of this section, the average mutual earnings rate for any calendar year is the percentage (determined by the Secretary) which—

(1) the aggregate statement gain or loss from operations for such year of domestic mutual life insurance companies, is of

(2) their aggregate average equity bases for such year.

(f) RECOMPUTATION IN SUBSEQUENT YEAR.—

(1) INCLUSION IN INCOME WHERE RECOMPUTED AMOUNT GREATER.—In the case of any mutual life insurance company, if—

(A) the recomputed differential earnings amount for any taxable year, exceeds

(B) the differential earnings amount determined under this section for such taxable year,

such excess shall be included in life insurance gross income for the succeeding taxable year.

(2) DEDUCTION WHERE RECOMPUTED AMOUNT SMALLER.—In the case of any mutual life insurance company, if—

(A) the differential earnings amount determined under this section for any taxable year, exceeds

(B) the recomputed differential earnings amount for such taxable year,

such excess shall be allowed as a life insurance deduction for the succeeding taxable year.

(3) RECOMPUTED DIFFERENTIAL EARNINGS AMOUNT.—For purposes of this subsection, the term "recomputed differential earnings amount" means, with respect to any taxable year, the amount which would be the differential earnings amount for such taxable year if the average mutual earnings rate taken into account under subsection (c)(1)(B) were the average mutual earnings rate for the calendar year in which the taxable year begins.

(4) SPECIAL RULE WHERE COMPANY CEASES TO BE MUTUAL LIFE INSURANCE COMPANY.—Except as provided in section 381(c)(22), if—

(A) a life insurance company is a mutual life insurance company for any taxable year, but

(B) such life insurance company is not a mutual life insurance company for the succeeding taxable year,

any adjustment under paragraph (1) or (2) by reason of the recomputed differential earnings amount for the first of such taxable years shall be taken into account for the first of such taxable years.

(5) SUBSECTION NOT TO APPLY FOR PURPOSES OF ESTIMATED TAX.—Section 6655 shall be applied to any taxable year without regard to any adjustment under this subsection for such year.

* * * *

TREASURY REGULATIONS ON INCOME TAX (26 C.F.R.):

**§ 1.809-9. Computation of the differential earnings rate and the recomputed differential earnings rate.**

(a) *In general.* Neither the differential earnings rate under section 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under section 809(f)(3) may be less than zero.

(b) *Definitions*—(1) *Recomputed differential earnings amount.* The recomputed differential earnings amount, with respect to any taxable year, is the amount equal to the product of—

(i) The life insurance company's average equity base for the taxable year; multiplied by

(ii) The recomputed differential earnings rate for that taxable year.

(2) *Recomputed differential earnings rate.* The recomputed differential earnings rate for any taxable year equals the excess of—

(i) The imputed earnings rate for the taxable year; over

(ii) The average mutual earning rate for the calendar year in which the taxable year begins.

(c) *Effective date.* The regulations are effective for all taxable years beginning after December 31, 1986.

(2)

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No. 95-105

# In the Supreme Court of the United States

OCTOBER TERM, 1995

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AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES, PETITIONER

*v.*

UNITED STATES OF AMERICA

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT*

---

## BRIEF FOR THE UNITED STATES IN OPPOSITION

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23 pp

## QUESTION PRESENTED

Section 809 of the Internal Revenue Code, 26 U.S.C. 809, requires mutual life insurance companies to reduce deductions for policyholder dividends by an amount derived from the excess of the average stock company earnings rate over the average mutual company earnings rate. The question presented is whether Section 809 authorizes a mutual company, in a year in which the average mutual company earnings rate exceeds the average stock company earnings rate, to take a policyholder dividends deduction in an amount that is greater than the actual amount of its dividends.

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# In the Supreme Court of the United States

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*v.*

UNITED STATES OF AMERICA

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## BRIEF FOR THE UNITED STATES IN OPPOSITION

---

### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-9a) is reported at 43 F.3d 1172. The opinion of the district court (Pet. App. 10a-17a) is unofficially reported at 73 A.F.T.R.2d ¶ 94-301.

### JURISDICTION

The judgment of the court of appeals was entered on December 15, 1994. A petition for rehearing was denied on March 21, 1995. Pet. App. 20a. On June 9, 1995, Justice Thomas extended the time within which to file a petition for a writ of certiorari to and including July 19, 1995, and the petition was filed on

that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATEMENT

1. This case presents an issue of first impression under Section 809 of the Internal Revenue Code, 26 U.S.C. 809. Section 809, entitled "Reduction in certain deductions of mutual life insurance companies," is the most recent congressional effort to address the problem of the deductibility of dividends paid by mutual life insurance companies to their policyholders. As noted by the court of appeals (Pet. App. 2a), the problem stems from the fact that a mutual insurance company's policyholders are both its customers and its owners. Because of that dual status, it is difficult to determine what portion of a mutual company's dividends to its policyholders represents a price rebate to customers (which is deductible) and what portion represents a distribution of earnings to owners (which is nondeductible). Taxation of stock life insurance companies, which may also distribute dividends to their policyholders as well as their stockholders, does not present that problem, because their policyholders and stockholders are not necessarily the same persons.

The solution adopted by Congress in Section 809 is based on the theory that the excess of the earnings rates of stock life insurance companies (after payment of policyholder dividends but before distribution of dividends to stockholders) over those of mutual companies (after the payment of policyholder dividends) is a reasonable measure of that portion of mutual companies' policyholder dividends that is attributable to the distribution of earnings to policyholders in their capacity as owners. When Congress

enacted Section 809, "the after [policyholder] dividend rates of return on equity for both stock and mutual companies were examined, and it was determined that the average pre-tax return on equity of mutual companies [fell] below that for a comparable group of stock companies. [The Congress] believe[d] that this difference [was] attributable to distribution by mutual companies of earnings to their owners." H.R. Rep. No. 432, 98th Cong., 2d Sess. Pt. 2, at 1422 (1984) (*House Report*); see also H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1057 (1984) (adopting House provision); Senate Comm. on Finance, 98th Cong., 2d Sess., *Deficit Reduction Act of 1984*, at 548-549 (Comm. Print 1984).

Section 809 operates in conjunction with the rules for deduction of policyholder dividends contained in Section 808 of the Code. Section 808(c)(1) sets forth the general rule providing a deduction to life insurance companies for "policyholder dividends * * * [in] an amount equal to the policyholder dividends paid or accrued during the taxable year." Section 808(c)(2) then limits that deduction for mutual companies by providing that, "[i]n the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809."

Section 809(a)(1), in turn, provides that, for mutual companies, "the amount of the deduction allowed under section 808 shall be reduced" by the "differential earnings amount," which is computed under Section 809(a)(3) and 809(c)(1). The "differential earnings amount" for a particular taxable year is derived in two steps. First, the "differential earnings rate" is computed, by calculating the "excess" of the earnings rate of the stock life insurance industry for

the three-year period before the taxable year in question[1] over the post-dividend earnings rate of the mutual life insurance industry for the second calendar year antedating the taxable year in question. 26 U.S.C. 809(c)(1)(B).[2] The "differential earnings rate" is then multiplied by the particular mutual company's "average equity base." 26 U.S.C. 809(a)(3).[3] The product is the differential earnings amount. *Ibid.*

Because the initial reduction of mutual companies' deductions under Section 809(c)(1) for any tax year is based on two-year-old data on mutual companies'

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[1] This figure is known as the "imputed earnings rate." 26 U.S.C. 809(c)(1)(A), 809(d). The imputed earnings rate represents the average of the earnings rates of the 50 largest stock insurance companies for the three-year period antedating the taxable year in question, multiplied by .9055. The legislative history explains that the three-year period was used "to preclude the possibility of sharp rises or declines in the rate of return for the stock segment of the industry, giving the mutual companies some ability to plan for and predict tax costs for purposes of marketing their products." *House Report* 1423. The .9055 figure reflects the fact that Congress chose to adjust future imputed earnings rates by the ratio which the rate that Congress decided was an appropriate rate for 1984 (16.5%) bore to the actual stock rate for 1981 through 1983 (18.221%). 26 U.S.C. 809(d)(1)(B).

[2] The two-year lag in computing the average mutual company earnings rate "is necessary because, for any taxable year, the Secretary will not have the data required to determine the average mutual earnings rate prior to the date a mutual company will file its Federal income tax return." *House Report* 1425.

[3] The "average equity base" (which consists of the company's surplus and capital) is the average of the equity base at the conclusion of the taxable year and the equity base at the conclusion of the prior taxable year. 26 U.S.C. 809(b)(1) and (2).

earnings, the Code requires an adjustment in the following year, after information has become available about the mutual earnings rate for the year in which the dividends in question were paid or accrued. 26 U.S.C. 809(f)(3). Specifically, Section 809(f)(3) requires the calculation of a "recomputed differential earnings amount," which is computed in the same manner as the original differential earnings amount is calculated under Section 809(c)(1), but using the up-to-date information about the average mutual company earnings rate for the taxable year. Under Section 809(f)(2), if the original differential earnings amount exceeds the recomputed differential earnings amount, "such excess shall be allowed as a life insurance deduction for the succeeding taxable year"; the adjustment compensates the company for its excessive reduction of its policyholder dividend deduction in the original taxable year. Conversely, if the recomputed differential earnings amount exceeds the original differential earnings amount, "such excess shall be included in life insurance gross income for the succeeding taxable year," to compensate the government for the excessive deduction taken in the original taxable year. 26 U.S.C. 809(f)(1).

2. Petitioner is a mutual life insurance company that paid or accrued $13,985,737 in policyholder dividends in 1986. On its 1986 federal income tax return, petitioner reported a "differential earnings amount" of $9,826,925, based on mutual companies' earnings data for 1984. Accordingly, petitioner reduced its policyholder dividends deduction for 1986 to $4,158,812 ($13,985,737 minus $9,826,925). Pet. App. 4a.

On its 1987 federal income tax return, petitioner reported a *negative* "recomputed differential earnings amount." Pet. App. 4a. The negative figure

reflected the fact that, contrary to Congress's expectation, the imputed (stock company) earnings rate in 1986 was *less* than the average mutual company earnings rate for the same year (which became available during 1987). Petitioner contended that the (recomputed) "differential earnings rate" (defined in Section 809(c)(1) as the "excess" of the stock earnings rate over the mutual earnings rate) therefore was *negative* 1.7%.[4] That negative differential earnings rate, in turn, yielded a recomputed differential earnings amount of *negative* $1,580,476. As noted above, petitioner's original differential earnings amount for 1986 was $9,826,925. Using those two differential earnings figures, petitioner claimed an adjusted policyholder deduction for 1987 of $11,407,401, which (petitioner claimed) represented the "excess" of $9,826,925 over -$1,580,476. *Id.* at 4a-5a. Because petitioner had already taken a $4,158,812 "policyholder dividends deduction" in 1986, petitioner, in effect, claimed deductions totaling $15,566,213 with respect to its policyholder dividends for 1986, even though it paid or accrued only $13,985,737 in policyholder dividends during that year. *Ibid.*

Petitioner's computation engendered a loss for 1987, which it attempted to carry back to offset income earned during the 1984 taxable year. Pet. App. 13a. Petitioner then filed a claim with the Internal Revenue Service (IRS) seeking a refund of $729,163 in tax paid for 1984, plus interest. *Id.* at 14a. After the

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[4] The imputed earnings rate for taxable year 1986 was 16.285%. Rev. Rul. 87-92, 1987-2 C.B. 165, 166. The mutual earnings rate for that year was 17.980%. Rev. Rul. 88-80, 1988-2 C.B. 129, 130.

IRS denied the refund claim, petitioner filed a refund suit in district court.

3. The district court granted petitioner's motion for summary judgment. Pet. App. 10a-17a. The court rejected the government's argument that the adjustment to the deduction set forth in Section 809(f)(2) must be interpreted in conjunction with Section 808(c), which limits a mutual company's policyholder dividends deduction to the amount of dividends paid or accrued during the taxable year. Pet. App. 16a. It therefore concluded that petitioner was entitled to deduct the entire $11,407,401 that it claimed as a life insurance deduction for 1987. *Id.* at 17a.

Shortly after the district court's decision, the Department of the Treasury, acting pursuant to prior published notice,[5] issued a regulation providing in part that "[n]either the differential earnings rate under section 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under section 809(f)(3) may be less than zero." Treas. Reg. § 1.809-9(a).[6] The regulation is effective for all taxable years beginning after December 31, 1986. Treas. Reg. § 1.809-9(c).

4. The court of appeals reversed the district court's decision on two independent grounds. Pet. App. 1a-9a. The court first agreed with the govern-

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[5] See Notice 88-106, 1988-2 C.B. 444, 445; Rev. Rul. 88-80, 1988-2 C.B. 129, 130; Notice of Proposed Rulemaking, 1992-2 C.B. 680.

[6] The accompanying statement explains that, "[w]henever the average mutual earnings rate is greater than the imputed earnings rate, there is no 'excess of' the imputed rate over the average mutual earnings rate." T.D. 8499, 1993-2 C.B. 246.

ment that Section 808(c) limits the deduction that a mutual company may take, under Section 809, with respect to policyholder dividends paid or accrued in a given year, to the total amount of those dividends. Pet. App. 6a. The court of appeals noted that Section 805 specifically provides that deductions "in respect of policyholder dividends" are subject to the limitations imposed by Section 808, and it observed that the Section 809 deduction sought by petitioner in this case "functions as an adjustment 'in respect of policyholder dividends.'" *Ibid.* Hence, the court concluded, "the requirements of section 808(c) must apply to section 809." *Ibid.*

The court also held that the plain language of Section 809(c)(1) precludes a negative recomputed differential earnings rate. Pet. App. 7a. The court noted that the statute defines the recomputed differential earnings rate to be the "excess" of the imputed (stock company) earnings rate over the average mutual company's earnings rate. It concluded that Congress "expected, and thus intended, that 'excess' would be a positive number," and it observed that "[t]he term 'excess' * * * is more susceptible to a reading as a positive number than as a negative number." *Ibid.* The court rejected petitioner's argument that an alleged special insurance industry understanding of the term "excess" should apply, stating that "[l]anguage used in tax statutes should be read in the ordinary and natural sense." *Ibid.*[7]

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[7] The court of appeals concluded that Treasury Regulation § 1.809-9 provides a reasonable interpretation of the statute (Pet. App. 8a) but stated that its decision would have been the

## ARGUMENT

The court of appeals correctly concluded that Section 809 does not permit a mutual life insurance company to receive a deduction for policyholder dividends in excess of the dividends that it actually paid or accrued during the taxable year. That decision does not conflict with any decision of this Court or of any other court of appeals. Further review therefore is not warranted.

1. a. Section 809(c)(1) provides that the recomputed differential earnings rate shall be the "excess" of the imputed (stock company) earnings rate over the average mutual earnings rate (adjusted to reflect accurate mutual company earnings data for the taxable year, see 26 U.S.C. 809(f)(3)). The court of appeals correctly concluded that the Internal Revenue Code's use of the term "excess" does not permit a negative recomputed differential earnings rate. In construing the Code, courts "look to the 'ordinary, everyday senses' of the words" used therein, *Commissioner* v. *Soliman*, 113 S. Ct. 701, 705 (1993), and, as the court of appeals observed (Pet. App. 7a), the generally accepted understanding of "excess" is limited to positive figures. One dictionary defines "excess" as "the amount or degree by which one thing or number exceeds another," *Webster's Third New International Dictionary* 792 (1986) (def. 1c), and provides, as an example of the usage of "excess," the following: "[T]he [excess] of 12 plus 2 over 12 minus 2 is 4." *Ibid.* The same dictionary further defines

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same even if it had accepted petitioner's contention that the regulation should be disregarded in this case (*id.* at 9a).

"exceed" as "to be greater than or superior to: SURPASS." *Id.* at 791 (def. 2a).

Those definitions demonstrate that there is no "excess" of the imputed earnings rate over the average mutual earnings rate when the former is less than the latter. The commonly accepted characterization of the relation between numbers is that 16.285 (the imputed stock mutual earnings rate for 1986) is *less than* 17.980 (the mutual earnings rate for the same year), by 1.695. That characterization is directly at odds with the notion that an "excess" of A over B can exist when A is less than B, for "to be less than" is the opposite of "to be greater than," one of the definitions of "exceed." An antonym should ordinarily not be read as a synonym in construing a statute.

b. The court's rejection of a negative meaning for "excess" in Section 809(c)(1) is consistent with the Code's use of the same term in Section 809(f). See *Commissioner* v. *Keystone Consol. Indus., Inc.*, 113 S. Ct. 2006, 2011 (1993) ("[I]dentical words used in different parts of the same act are intended to have the same meaning."). Section 809(f) provides, in pertinent part, as follows:

> **(f) Recomputation in subsequent year**
>
> **(1) Inclusion in income where recomputed amount greater**
>
> In the case of any mutual life insurance company, if—
>
> (A) the recomputed differential earnings amount for any taxable year, exceeds
>
> (B) the differential earnings amount determined under this section for such taxable year,

*such excess* shall be included in life insurance gross income for the succeeding taxable year.

**(2) Deduction where recomputed amount smaller**

In the case of any mutual life insurance company, if—

(A) the differential earnings amount determined under this section for any taxable year, exceeds

(B) the recomputed differential earnings amount for such taxable year,

*such excess* shall be allowed as a life insurance deduction for the succeeding taxable year.

(Emphasis added.) Those mirror-image provisions clearly indicate that Congress understood and intended an "excess" to be a positive figure. Section 809(f)(1) states that, when the recomputed differential earnings amount is *greater than* ("exceeds") the differential earnings amount, "such excess," a positive figure, shall be added to life insurance gross income for the succeeding taxable year. Section 809(f)(2) states conversely that, when the differential earnings amount is *greater than* ("exceeds") the recomputed differential earnings amount, "such excess," a positive figure, shall be subtracted from life insurance gross income for the succeeding taxable year. The language and structure of Section 809(f) thus reveal that Congress understood that there is no "excess" of A over B unless A is greater than B.[8]

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[8] Congress's understanding of "excess" as a positive figure is also reflected in Section 809(a). Section 809(a)(1) provides that "the amount of the [policyholder dividends] deduction allowed under section 808 shall be reduced (but not below zero)

c. Finally, the court of appeals' decision is supported by a common-sense understanding of Congress's intent in enacting the statute, as reflected in Section 809's headings. Section 809 is titled, "Reduction in certain deductions of mutual life insurance companies." Section 809(a)(1) then provides the "[g]eneral rule" for reductions, with reference to "[p]olicyholder dividends." Those headings reinforce the court of appeals' conclusion that Congress intended Section 809 to operate as a limitation on mutual life insurance companies' deductions for policyholder dividends. While the headings of a statute cannot override a clear statutory text to the contrary, they can be used to dispel lingering uncertainty about the meaning of a statute, especially where, as here, the headings demonstrate that Congress intended the statute to have a "limited function." *Mead Corp.* v. *Tilley*, 490 U.S. 714, 723 (1989); see *Maguire* v. *Commissioner*, 313 U.S. 1, 9 (1941). The headings of Section 809 confirm that Congress did not intend mutual insurance companies to increase their deductions *above* the amount that they paid out in policyholder dividends. Cf. *United States* v. *Skelly Oil Co.*, 394

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by the differential earnings amount." Section 809(a)(2) further provides that, "if the differential earnings amount exceeds the amount allowable as a deduction under section 808 for the taxable year[,] * * * such excess shall be taken into account under subsections (a) and (b) of section 807," with respect to a mutual company's reserve deduction. The term "excess" in Section 809(a)(2) clearly refers to a positive figure, *viz.*, the amount by which the differential earnings amount is greater than the amount of the policyholder dividends deduction. Where the differential earnings amount is *less than* the amount of the policyholder dividends deduction, that deduction is not reduced below zero, and Section 809(a)(2) does not operate.

U.S. 678, 684 (1969) (rejecting approach that would allow taxpayer a total of $1.27 in deductions for every $1 refunded to its customers). If Congress had intended to grant mutual companies a windfall tax deduction, it would not have done so through a provision that, by its own terms, is intended to reduce their deductions. Cf. *Colonial American Life Ins. Co.* v. *Commissioner*, 491 U.S. 244, 260 (1989) ("We find it incredible that Congress * * * would have tucked away * * * a deduction of this magnitude.").

2. The court of appeals' alternative holding, that the recalculation deduction provided in Section 809(f)(2) is subject to the limitation established in Section 808—which does not permit a mutual company to deduct more than it paid out in policyholder dividends during a particular year—is also correct. Section 804 sets forth the "life insurance deductions" available to life insurance companies, including "the general deductions provided in section 805." 26 U.S.C. 804(1). The final sentence of Section 805(a) expressly provides that "no amount shall be allowed as a deduction * * * in respect of policyholder dividends," except as provided in Section 805(a)(3). Section 805(a)(3), in turn, incorporates the policyholder dividends deduction "determined under section 808(c)." Because the recalculation deduction provided in Section 809(f)(2) is simply a modification of the Section 808(c) policyholder dividends deduction that was calculated in the prior year, it functions as an adjustment "in respect of policyholder dividends." It is therefore subject to the restrictions of Section 808, under the plain language of Section 805. And, under Section 808, the policyholder dividend deduction is limited to "an amount equal to the policyholder dividends paid or accrued during the taxable year." 26

U.S.C. 808(c)(1). Petitioner's attempt to take a dividend deduction in excess of the amount of its dividends therefore contravenes Sections 805 and 808.

The limitation of Section 809 by Section 808 is also apparent from the language of those two Sections. Section 808(c), after setting forth the deduction for policyholder dividends, provides that the deduction "shall be reduced by the amount determined under section 809." 26 U.S.C. 808(c)(2). Section 809(a)(1), in turn, states that "the amount of the deduction allowed under section 808 shall be reduced * * * by the differential earnings amount." Those two sentences make clear that the function of Section 809 is to reduce, not to increase, the deduction allowed in Section 808.

The contrary reading advocated by petitioner effectively reduces Section 808 "to trivial application." *United States* v. *Nordic Village, Inc.*, 503 U.S. 30, 35 (1992). Section 808(c) limits the policyholder dividends deduction to the amount of dividends actually paid or accrued during the taxable year, but, under petitioner's reading, that restriction would be effective only for the year (here, 1986) in which the (essentially temporary) differential earnings amount is computed. The restriction would be neutralized when the recomputed differential earnings amount is determined in the following year.

Finally, petitioner's attempt to gain support from the fact that Congress called the Section 809(f)(2) recalculation deduction a "life insurance deduction" rather than a "policyholder dividends deduction" is wide of the mark. The term "life insurance deduction" includes both the policyholder dividends deduction (Sections 804(1) and 805(a)(3)) and the reserve deduction (Sections 804(1) and 805(a)(2)).

Congress's use of the broader term reflects the fact that, on occasion, the original year's differential earnings amount may have reduced the reserve deduction as well as the policyholder dividends deduction.

3. Petitioner contends (Pet. 6-9, 22, 25) that, as a matter of policy, allowing mutual companies to take dividend deductions exceeding their dividends produces a statistically correct reduction in the mutual industry's deductions over time. In essence, petitioner contends that Congress was willing to grant the mutual industry a windfall deduction in some years on the assumption that the amounts of deductions would even out over time. See Pet. 8. As the court of appeals observed in rejecting that argument, however, "there is no evidence that this was what Congress had in mind." Pet. App. 8a.[9] Even if an economic case could be made to Congress for allowing petitioner the windfall deduction that it seeks, petitioner's policy argument cannot surmount the fundamental limitation on policyholder dividend deductions placed by Congress in the Code: Life

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[9] The fallacy in petitioner's argument is further revealed by the fact that Section 809 compares noncurrent data (from one to three years before the taxable year) about stock insurance companies with data about mutual companies that are current (after application of the Section 809(f) recalculation). If Congress had been concerned about achieving petitioner's concept of statistical purity, it would not have required a comparison of earnings rates from different periods. Congress evidently decided that any disadvantage to mutual companies from an imprecise matching of years was outweighed by the benefit to them of the elimination of any possible "sharp rises or declines in the rate of return for the stock segment of the industry, giving the mutual companies some ability to plan for and predict tax costs for purposes of marketing their products." *House Report* 1423.

insurance companies cannot take deductions for dividends that exceed the actual amount of their dividends in the same year.

4. Petitioner stresses (Pet. 28-29) that the IRS had issued notices and rulings indicating that the "excess" in Section 809(c)(1) may be negative. The IRS subsequently conformed its position, however, to the correct reading of the statute. Petitioner points to no authority forbidding the government to correct an erroneous interpretation of the law.[10] See *Dickman* v. *Commissioner*, 465 U.S. 330, 343 (1984); cf. *OPM* v. *Richmond*, 496 U.S. 414 (1990) (government cannot be estopped to deny disability benefits that were not otherwise permitted by law because of erroneous advice given by government employee). Petitioner's reliance (Pet. 21, 23-24, 28) on the 1989 Treasury Department Report to Congress on the operation of Section 809 is also misplaced. The 1989 Report did not purport to interpret the language of

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[10] Originally, in March 1988, the IRS reported that the tentative recomputed differential earnings rate for 1986 was "-1.700." Announcement 88-47, 1988-12 I.R.B. 56. Later in the same year, the IRS changed its view and took the position that there could not be a negative rate. Notice 88-106, 1988-2 C.B. 444; Rev. Rul. 88-80, 1988-2 C.B. 129. Although continuing to assert that there could not be a negative rate, the IRS did include statements in rulings that, "[b]ut for the rule described in Notice 88-106," a particular rate would be a specified negative number. See, *e.g.*, Rev. Rul. 89-106, 1989-2 C.B. 109. Ultimately, in the preamble to the final regulations, the Treasury stated that, "[w]henever the average mutual earnings rate is greater than the imputed earnings rate, there is no 'excess of' the imputed earnings rate over the average mutual earnings rate," and thus concluded that a negative rate is precluded by the statutory formula itself. T.D. 8499, 1993-2 C.B. 246.

Section 809; rather, it discussed perceived problems with the statute as enacted. As is clear from the promulgation of Treasury Regulation § 1.809-9 in December 1993, the Treasury Department does not believe that Section 809 should be interpreted as allowing mutual companies to deduct more than they pay out. Thus, the Treasury's now-definitive published interpretation, the decision below (the only appellate decision on the question), and the plain language of the statute are all in agreement.

5. Finally, petitioner contends (Pet. 29-30) that the Court should grant certiorari, even in the absence of an intercircuit conflict, because of the amount of money at issue. That contention is without merit. Although the Court has, on occasion, granted certiorari in large tax cases in the absence of a conflict in the circuits, such as *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132 (1989), and *United States* v. *Hill*, 113 S. Ct. 941 (1993), those cases involved demonstrably incorrect decisions, adverse to the government, of the United States Court of Appeals for the Federal Circuit, which has national jurisdiction in appeals in tax refund cases. Because, in *Goodyear* and *Hill*, every taxpayer could take advantage of the Federal Circuit's decisions by filing a refund suit in the Court of Federal Claims, the Federal Circuit's decisions in those cases effectively constituted the law of the land, in the absence of review by this Court.[11]

The same situation does not exist with respect to the issue presented in this case. The decision below

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[11] See also our pending petition for a writ of certiorari in *United States* v. *Xerox Corp.*, No. 94-2005 (filed June 7, 1995), similarly seeking review of a Federal Circuit decision.

is binding only in the Eighth Circuit, and even other companies located there can bring the issue to the Court of Federal Claims and then to the Federal Circuit. Indeed, another case presenting the same issue is pending in the United States District Court for the Southern District of Indiana. *Indianapolis Life Ins. Co. & Subsidiary* v. *United States*, No. 95-770. In the absence of any disagreement among the courts of appeals on the issue presented in this case, further review of the issue is not warranted.[12]

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1995

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[12] The third case cited by petitioner, *Harrison* v. *Northern Trust Co.*, 317 U.S. 476 (1943), involved an unusual situation. In that case, the Seventh Circuit elected to follow a prior decision of this Court, *Edwards* v. *Slocum*, 264 U.S. 61 (1924), that had been overruled by a subsequent statute. Because the Seventh Circuit's decision was plainly contrary to the amended statute, and because the question was of substantial fiscal importance, the government sought review by this Court.

No. 95-105

Supreme Court, U.S.
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IN THE
# Supreme Court of the United States
OCTOBER TERM, 1995

AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,
*Petitioner,*
v.
UNITED STATES,
*Respondent.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit**

## BRIEF *AMICI CURIAE* OF ALLMERICA FINANCIAL CORPORATION, THE AMERICAN HOME LIFE INSURANCE COMPANY, AMERITAS LIFE INSURANCE CORPORATION, BALTIMORE LIFE INSURANCE COMPANY, BOSTON MUTUAL LIFE INSURANCE COMPANY, CENTRAL STATES HEALTH & LIFE COMPANY OF OMAHA, CENTURY LIFE OF AMERICA, FARMERS & TRADERS LIFE INSURANCE COMPANY, GOVERNMENT PERSONNEL MUTUAL LIFE INSURANCE COMPANY, GUARANTEE MUTUAL LIFE COMPANY, THE HOMESTEADERS LIFE COMPANY, ILLINOIS MUTUAL LIFE AND CASUALTY COMPANY, INDIANAPOLIS LIFE INSURANCE COMPANY, JOHN HANCOCK MUTUAL LIFE

(*Amici Curiae Continued on Inside Cover*)

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## QUESTION PRESENTED

Should § 809 of the Internal Revenue Code, which imputes income to mutual life insurance companies according to a formula that compares one time period with another, be interpreted to alter the formula's results in tax years when those results favor the taxpayer—thus vastly increasing the tax liability of mutual companies relative to stock companies?

## STATEMENT PURSUANT TO RULE 29.1

*Amici* except as noted have no parent companies and no subsidiaries other than wholly-owned subsidiaries and those with no public ownership. Union Central Life Insurance Company owns 73% of the shares of The Manhattan Life Insurance Company, the remaining shares of which are publicly traded. Physicians Life Insurance Company is a wholly owned subsidiary of Physicians Mutual Life Insurance Company. Illinois Mutual Life and Casualty Company has a publicly traded subsidiary, Morton Federal Savings Bank, FSB. Pacific Mutual Life Insurance Company has an ownership interest in PIMCO Advisors L.P., a publicly traded company. Allmerica Financial Corporation a subsidiary of State Mutual Life Insurance Company, owns shares in two publicly traded subsidiaries, Citizens and SMA Financial Corporation. Allmerica after conversion to stock ownership will be known as First Allmerica Financial Life Insurance Company. Century Life of America is owned by Century Companies of America, an affiliate of CUNA Mutual Insurance Group.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1995

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No. 95-105

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AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,

*Petitioner,*

v.

UNITED STATES,

*Respondent.*

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**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit**

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## BRIEF *AMICI CURIAE* OF ALLMERICA FINANCIAL CORPORATION, *et al.*, IN SUPPORT OF PETITIONER

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### INTEREST OF THE *AMICI*

*Amici* are thirty-nine mutual life insurance companies located throughout the United States. The federal tax liability of each for 1987 and several later years, amounting for the industry to billions of dollars, depends on the interpretation of § 809 of the Internal Revenue Code announced by the Eighth Circuit in this case. The Government repeatedly emphasized to the Court of Appeals

> "the importance of the issue presented, which arises with respect to *all* mutual companies." [1]

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[1] Brief for the Appellant, No. 94-1440, U.S.C.A., Eighth Cir., at i (emphasis in original) (hereinafter "Government's Brief"); see also *id.* at 33 n.10. Twenty-four mutual life insurance companies, 15 of them signatories to this brief, are located in the Eighth Circuit.

The decision also creates a major new competitive disadvantage for *amici* with respect to the stock insurance companies with which they compete, and may force some of *amici* to abandon the mutual policyholder form of ownership and reorganize instead as stock companies.

Pursuant to this Court's Rule 37.2, petitioner and respondent have consented to the filing of this brief.

## STATEMENT

*Amici* adopt the statement of the case set forth in the petition for certiorari. *Amici* underscore the following aspects of the record:

1. Until this case reached the Court of Appeals, the Government conceded in this litigation that the formula specified in § 809, which compares one time period with another, occasionally will result in a negative number.[2] A negative number occurred here because, as a result of annual fluctuations in the earnings of all insurance companies, the average returns of mutuals in 1986 exceeded the average for stock companies in 1983-85. The IRS duly published an announcement of this negative number, for use in preparing 1987 tax returns. P. 5a, *infra*. The Government also conceded in the District Court that the number calculated pursuant to the statute was negative. P.C.A. 14a.[3]

2. The Government argued in the District Court that, although the statute contains no such proviso, the "life insurance deduction" authorized in § 805(a)(8) and calculated by § 809(f) should be limited so as not to exceed,

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[2] The District Court pointed out that "[t]he parties are in agreement that the formula contained in section 809(c)(1) and 809(f)(3) yields a 1986 recomputed differential earnings rate of −1.695 percent and, in turn, a 1986 recomputed differential earnings amount of −$1,580,476." P.C.A. 14a. (References to "P.C.A." are to the appendix to the petition for certiorari.)

[3] The Government's case in the District Court was presented by attorneys of the Tax Division of the Department of Justice.

when combined with the "policyholder dividend deduction" authorized in § 805(a)(3) and calculated under § 808 (c)(2), the policyholder dividends for that year. See P.C.A. 15a. The District Court rejected that argument because, it held, the "policyholder dividend deduction" (computed in 1986) and the "life insurance deduction" (computed in 1987) are two separate provisions. "This language of section 809(f)(2) . . . . on its face unambiguously provides for a life insurance deduction of $11,407,401," the court held. P.C.A. 15a. "[The Government's] assertion that section 808(c) [the "policyholder dividend deduction"] should be read into section 809(f)(2) [the "life insurance deduction"] . . . disregards the statutory language." P.C.A. 16a.

> "To read section 808(c) into section 809(f)(2), as [the Government] asks the court to do, would effectively rewrite the statute. It is for Congress, not the courts, to rewrite statutes." *Id.*

3. On appeal, the Government retracted its previous concession that the subtraction prescribed in § 809(c)(1) in some years will produce a negative number. The Government told the Court of Appeals that

> "[T]he Government made an erroneous legal concession during the district court proceedings. Specifically, the Government conceded (in a memorandum of law) that when the average mutual earnings rate exceeds the imputed earnings rate, 'the formula contained in section 809(c) yields a negative differential earnings rate which, in turn, yields a negative differential earnings amount.' . . . In other words, the Government conceded that the 'excess of' 16.285 over 17.980 is minus 1.695, despite the fact that this characterization is contrary to the plain meaning of the word 'excess.' As a result, *the Government* further *acknowledged that strict application of the Section 809(f) formula* (at least when considered in isolation) *supported taxpayer's position in this case.*"

Government's Brief at 29-30 (emphasis supplied).

The Government's new appellate attorneys then "develop[ed] the winning theory for the government in its victory." P. 1a, *infra*. That "winning theory" was contrary to what the Government had conceded before, not only in this litigation but in the published bulletins of the IRS.[4] But the new theory persuaded the Court of Appeals, which was repeatedly admonished by the Government that otherwise a "multibillion dollar windfall" [5] was about to occur.

The Government's new "winning theory" asserted that—in spite of the statutory formula specified in § 809(f)(2)—the recomputed differential earnings rate should not be allowed to be less than zero. That was because, the Government argued, the amount of the "life insurance deduction" along with the "policyholder dividend deduction" should not be allowed to exceed the amount of policyholder dividends for a particular year. The "life insurance deduction" of § 809(f), urged the Government, was to be downgraded to merely a technical adjustment to the prior year's "policyholder dividend deduction." The Court of Appeals entirely accepted the Government's new theory, not even mentioning that in the District Court the Government had conceded the opposite.

4. Both parties in the Court of Appeals recognized the importance and national impact of the case.[6]

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[4] From the enactment of § 809 in 1984 until this case, the Government agreed with the mutual life insurance companies that § 809's "recomputed differential earnings rate" can be a negative number. The IRS itself for use in applying § 809 published a negative "recomputed differential earning rate" of −1.7% for 1986. See Pet. Cert. 11-12; 1988-12 Int. Rev. Bull. 56, p. 5a, *infra*. The Court of Appeals pointed out that "[i]ndeed, in past years, the Internal Revenue Service acknowledged the possibility of a negative excess." P.C.A. 7a.

[5] Reply Brief for Appellant, No. 94-1440, U.S.C.A., Eighth Cir. (July 8, 1994), at 4 (hereinafter "Government's Reply Brief"); see also n. 19, *infra*.

[6] For that reason, petitioner did not object to the Government's change of position in the Court of Appeals, because "it is a con-

5. Subsequently the Government issued public praise for the skill of its appellate attorney in "developing the winning theory for the government in its victory." P. 1a, *infra*.

## SUMMARY OF ARGUMENT

This is an issue of almost unprecedented financial and fiscal impact, involving every mutual life insurance company in the country, and tax claims estimated by the Government itself at over $5 billion. In addition to directing a vast transfer of money from mutual policyholders to the federal government, the result of the decision is to alter and increase dramatically the tax liability of mutual companies relative to stock life insurance companies—exactly the *opposite* of what Congress was seeking to accomplish when it enacted § 809 to try to equalize the tax treatment of the two kinds of companies. The holding here makes no economic sense, and completely skews the relative tax burdens of the two parts of the life insurance industry. It is likely to cause a massive restructuring of that industry in the United States, the shifting of funds to stock companies, and the demise of the mutual form of life insurance organization.

That staggering macroeconomic impact calls for review by this Court. This is "an important question of federal law which has not been, but should be, settled by this Court." Supreme Court Rule 10.1(c). Moreover, the Court of Appeals violated this Court's holdings on statutory and administrative interpretation when it substituted its misunderstanding of congressional intent, to replace the formula Congress explicitly enacted in the statute. And it departed from the well settled rule of *Skidmore* v. *Swift &*

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tinuing issue . . . will arise in subsequent taxable years . . . will, in addition, arise in other cases." Brief of Plaintiff-Appellee, No. 94-1440, U.S.C.A., Eighth Cir., at 22 n.15. The Government called petitioner's position "forthright[]." Government's Reply Brief at 2 n.1.

*Co.*, 323 U.S. 134, 140 (1944), and instead accorded "great deference," P.C.A. 8a, to an IRS regulation adopted *after* the District Court's decision, a regulation that altered the agency's previously published contrary position.

## ARGUMENT IN SUPPORT OF CERTIORARI

### I. THE ISSUE AFFECTS EVERY MUTUAL LIFE INSURANCE COMPANY IN THE UNITED STATES.

There are more than 100 mutual life insurance companies in the United States, with tens of millions of policyholders. Every one of those companies, and every one of those policyholders, is affected by the Court of Appeals' misconstruction of § 809. The lengthy array of companies that have joined in this brief reflects the across-the-board importance of the issue. Affected also, indirectly but in very real terms, are the country's stock insurance companies, which are granted an enormous competitive advantage over mutuals by the ruling of the Court of Appeals here.[7] *Cf. United States* v. *American Bar Endowment*, 477 U.S. 105, 114 (1986) (pointing out that "the effective cost of ABE's insurance will be lower than the cost of competing policies that do not offer tax benefits").[8]

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[7] Responding at oral argument to the question "why would the stock companies be interested?," government counsel explained, Tr. of Oral Arg., Eighth Cir., at 13-14:

> "Because anything that affects the taxes of one in a competitive industry, affects the costs of one, would affect the other. If one side is paying lower taxes, then they have a competitive advantage."

[8] See also Reply Brief for the United States, *United States* v. *American College of Physicians*, No. 84-1737 (filed June 21, 1985): "the decision below is the first by a court of appeals to consider the question presented here," but "[w]e believe that the departure from even-handed administration of the tax laws required by the decision below is important enough—to the IRS, to Congress, and to respondent's taxpaying competitors in the marketplace—to warrant this Court's review." *Id.* at 10, 11. (Cert. granted, 473 U.S. 904 (1985).)

Ironically, it was in an effort roughly to equalize the tax treatment of stock and mutual life insurance companies that Congress enacted § 809 in the first place. See, *e.g.*, H.R. Rep. No. 98-432, 98th Cong., 2d Sess., Pt. II at 1422 (1984). The sponsors repeatedly explained that they wanted the tax code to treat stock and mutual companies alike, to "level that playing field."[9] The perverse result here, now embodied in a *post hoc* interpretive regulation the Court of Appeals also approved, turns out to be just the opposite of what Congress had in mind.[10] The decision imposes on the mutual companies a vast burden of $5 billion additional taxes—a burden that ultimately will fall on the tens of millions of mutual policyholders in the form of reduced dividends or increased premiums.

Apart from the sheer cost to mutual companies and their policyholders, the ruling below will likely alter the insurance industry. Stock companies already enjoy a number of advantages, such as access to capital markets, that are denied to mutuals. As a result, since 1984 15 mutual life insurance companies have ceased to be mutuals and have converted to stock ownership.[11]

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[9] *Tax Treatment of Life Insurance*, Hearings Before Subcomm. on Select Revenue Measures, House Comm. on Ways and Means, 98th Cong., 1st Sess. 76 (1983) (Chairman Stark); see additional citations at Pet. Cert. 23 n.8.

[10] *Cf. Portland Golf Club* v. *Commissioner*, 497 U.S. 154, 165 (1990) ("[t]o allow such an offset . . . would run counter to the principle of tax neutrality which underlies the statutory scheme"). *Cf. also* Brief for the United States, *United States* v. *American College of Physicians*, No. 84-1737 (filed Sept. 14, 1985), at 11 ("the decision below flouts Congress's design to achieve parity of tax treatment between exempt and non-exempt entities"); [Government's] Petition for Certiorari, *United States* v. *Hill*, No. 91-1421, at 14 (filed March 6, 1992): "The fiscal consequences of the decision in this case are enormous. . . . It enhances the perceived unfairness of the Code that Congress sought to remedy." (Cert. granted, 503 U.S. 1004 (1992).)

[11] *Amicus* Midland Life Insurance Company recently converted to stock ownership, and *amici* Allmerica Financial Corporation and Guarantee Mutual Life Company have obtained approval to do so.

That trend can be turned into a stampede by this ruling. Economists and other observers may differ as to whether such a restructuring of the insurance industry is a good thing. Surely none can deny that it will be a momentous change in a major segment of the United States economy. For such an alteration of American business to be provoked by a highly questionable reading of a tax provision—a provision that was intended to minimize rather than exacerbate the tax differences between the two forms of insurance ownership—is a consequence too far-reaching to go unreviewed by this Court. *Cf., e.g., NationsBank, N.A.* v. *Variable Annuity Life Ins. Co.*, 115 S. Ct. 810 (1995) (certiorari granted to decide whether certain national banks are barred from competing with insurance companies in selling annuities); *United States* v. *Atlas Life Ins. Co.*, 381 U.S. 233, 239 (1965) ("[w]e granted certiorari to consider this important question relating to the taxation of life insurance companies"); *Commissioner* v. *Lincoln Sav. & Loan Ass'n*, 403 U.S. 345, 346-47 (1971) ("[b]ecause of the importance of the issue for the savings and loan industry and for the Government, we granted certiorari").[12]

## II. THE SUM AT ISSUE IS GARGANTUAN.

The amount of tax that depends on the interpretation given § 809 exceeds $5 billion. That figure is so large that it is actually a significant fraction of the total revenue the federal government collects in corporate income taxes. In asking for reversal, the Government admonished the Court of Appeals:

> "At the outset, it [is] worth establishing what this issue involves. The issue presented here arises with

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[12] *Cf.* also [Government's] Petition for Certiorari, *FERC* v. *United Distribution Cos.*, No. 89-1453 (filed March 15, 1990), at 16 ("If allowed to stand, the decision will cause substantial disruption in the natural gas industry . . . .") (cert. granted, 496 U.S. 904 (1990)); Brief for the United States, *United States* v. *American College of Physicians, supra*, at 41 ("The decision below . . . has repercussions far beyond the tax revenue at stake").

> respect to *all* mutual life insurance companies. The issue has arisen in 1986 (the base year involved in this case), 1989, and 1991, and also (based on the IRS's tentative computation) has arisen in 1992. . . . The Internal Revenue Service has estimated that the invalidation of Treas. Reg. § 1.809-9 would result in a revenue loss of almost $2 billion for 1986, 1989 and 1991 alone."

Government's Reply Brief at 3 (emphasis in original). Subsequently the Government increased its estimate of the stakes to $5 billion, announcing in a press release that its appellate attorney's

> "handling of a life insurance case helped save the U.S. Treasury five billion dollars."

Department of Justice Press Release No. 93-355 (June 22, 1995), p. 1a, *infra*.

This Court on appropriate occasions has granted certiorari to review decisions interpreting federal statutes in which the sums at stake are extraordinarily large—though rarely approaching the $5 billion at issue here. See, *e.g.*, *United States* v. *Mitchell*, 463 U.S. 206, 211 n.7 (1983) ("the damages claimed in this suit alone may amount to $100 million"); *Commissioner* v. *Standard Life & Accident Ins. Co.*, 433 U.S. 148, 151 n.5 (1977) ("[w]e are informed that substantially more than $100 million is in dispute"); see also *Mobil Oil Exploration & Producing Southeast, Inc.* v. *United Distribution Cos.*, 498 U.S. 211, 213 (1991) ("[i]n light of the economic interests at stake, we granted certiorari").[13]

It is quite understandable that the Government would like an additional $5 billion in revenues. But the federal

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[13] See also [Government's] Petition for Certiorari, *United States* v. *Atlas Life Ins. Co.*, No. 489, OT 1964 (filed Sept. 11, 1964): "regarded as a 'test case' by the life insurance industry . . . will subject the government to . . . claims for refund of approximately $400,000,000 . . . . Staggering amounts of revenue turn upon the issue." *Id.* at 11, 16. (Cert. granted, 379 U.S. 927 (1964).)

government's fiscal situation does not provide reason for misapplying the Internal Revenue Code. On the contrary, it is a compelling reason for granting certiorari to resolve the matter. See *United States* v. *Hill*, 113 S. Ct. 941, 945 (1993) ("[b]ecause of the importance of the issue to the federal fisc, we granted certiorari"); *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132, 138 (1989) ("[t]o clarify the operation of the § 902 credit in the tax years to which it applies, we granted certiorari"); *Harrison* v. *Northern Trust Co.*, 317 U.S. 476, 478 (1943) ("[w]e granted certiorari because of the importance of the question in the administration of the federal estate tax system").[14] None of those cases involved a conflict of decisions in the lower courts, nor have a number of other cases that could be cited that raised national issues of tax law in which this Court has granted certiorari.

If the Eighth Circuit had affirmed the District Court's decision instead of reversing, there is little doubt that the Solicitor General would be petitioning this Court to grant certiorari, as the Government regularly does, without any conflict in the circuits, when major tax issues of nationwide impact are decided against it. *E.g.*, *United States* v. *Hill*, *supra*; *United States* v. *American College of Physicians*, 475 U.S. 834 (1986); *Commissioner* v. *Lincoln Sav. & Loan Ass'n*, *supra*; *United States* v. *Atlas Life Ins. Co.*, *supra*.[15] The need for decision by this Court

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[14] See also, *e.g.*, *Alaska* v. *American Can Co.*, 358 U.S. 224, 225 (1959) ("certiorari . . . was granted in view of the fiscal importance of the question to Alaska"); [Government's] Petition for Certiorari, *Commissioner* v. *Lincoln Sav. & Loan Ass'n*, No. 544 OT 1970 (filed Aug. 14, 1970), at 8: "The question presented in this case is of substantial fiscal and administrative significance." (Cert. granted, 400 U.S. 901 (1970).)

[15] In a currently pending petition, raising a question of interpretation of a tax treaty, the Government urges that "the correct disposition of this substantive question has a significant impact on the public fisc." Petition for Certiorari, *United States* v. *Xerox*

is just as great when the Government prevailed in a court of appeals, on this nationwide $5 billion issue.

## III. RESOLUTION BY THIS COURT WILL AVOID USELESS LITIGATION THROUGHOUT THE COUNTRY.

There are thirty-nine mutual life insurance companies submitting this brief. Because of the statute of limitations, many of them, and other mutual companies, particularly the smaller ones, face the imminent necessity of either giving up their full § 809 life insurance deduction claims for 1987, or filing suits throughout the country exactly like petitioner's here.[16] A greater waste of resources—not

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*Corp.*, No. 94-2005 (filed June 7, 1995), at 14. The Government adds that

> "Respondent claims . . . that the petition should be denied because there are no conflicting decisions. But we did not argue that the petition should be granted because of a conflict within the circuits."

Reply Brief for the United States, No. 94-2005 (filed Aug. 16, 1995), at 1. See also, currently pending, [Government's] Petition for Certiorari, *United States* v. *County of San Diego*, No. 95-128 (filed July 21, 1995) (issue of federal contractors' liability for state *ad valorem* taxes): "Several billions of dollars worth of federal properties are privately operated under federal management contracts in California alone. As a result, there is a significant administrative interest in the prompt resolution of the questions presented in this case." *Id.* at 14.

Last month, when a United States Court of Appeals entered a decision finding the Government liable for up to $1.5 billion to three savings and loan companies, and others similarly situated could claim $10 billion or more, the Government immediately announced that "the Justice Department plans to ask the Supreme Court to overturn" the decision "[b]ecause so much money is at stake." J. Knight, *Thrift Cleanup Costs May Soar*, Washington Post, Aug. 31, 1995, p. A1, col. 1; see *Winstar Corp.* v. *United States*, 1995 WL 509409 (Fed. Cir. 1995).

[16] The government recognized that "[t]his case . . . of course is being closely watched," "[t]here's a 100 some mutual companies," and "I'd be surprised if any company permanently gave up its right to litigate for the 86-87 years." Tr. of Oral Arg., Eighth Cir., at 16.

only the companies' but also the Government's—is difficult to imagine.

This is not the sort of issue in which a delayed review by this Court may acquire context or wisdom from awaiting different fact situations to be considered by other courts. There are no individual facts to consider. The issue, as the Government itself has repeatedly emphasized, is purely one of interpreting the national tax code. The identical issue, in the Government's words, "arises with respect to *all* mutual companies." Government's Brief, *supra*, at i (emphasis in original). There is no use in multiplying federal cases raising this inescapable tax issue for every mutual company in the country.[17]

To avoid such duplicative litigation and resolve nationwide issues of basic federal law is one reason this Court was established. See *United States* v. *Standard Oil Co.*, 332 U.S. 301, 302-03 & n.2 (1947) (certiorari granted "because of the novelty and importance of the principal question" where "the suit was also said to be representative of a number already commenced"). Indeed, this Court has previously granted certiorari without lower-court conflicts to review decisions that significantly affect the functioning of the insurance industry. *E.g.*, *United States* v. *Atlas Ins. Co.*, *supra*; *cf. NationsBank, N.A.* v. *Variable Annuity Life Ins. Co.*, *supra*. It does so for other important federal laws of national application as well. *E.g.*, *Andrus* v. *Utah*, 446 U.S. 500, 506 (1980) (certiorari to resolve "a significant issue regarding the disposition of vast amounts of public lands");

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[17] *Cf.* [Government's] Petition for Certiorari, *United States* v. *Goodyear Tire & Rubber Co.*, No. 88-1474 (filed March 8, 1989) (arguing that even though because of a subsequent amendment "the prospective impact of the decision below has been diminished somewhat," nevertheless certiorari should be granted because of "the numerous and substantial refund claims that are likely to be filed." *Id.* at 24, 26. "The decision below is of enormous importance to the public fisc . . . . massive revenue impact of the decision below." *Id.* at 22, 23.). (Cert. granted, 490 U.S. 1045 (1989).)

*Southeastern Community College* v. *Davis*, 442 U.S. 397, 404 (1979) ("[b]ecause of the importance of this issue to the many institutions covered by § 504, we granted certiorari"); *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 456 (1969) ("we granted certiorari because of the importance of the questions raised to the administration of the securities laws"). The list could be extended practically indefinitely.[18]

## IV. THE DECISION OF THE COURT OF APPEALS IS STRIKINGLY ERRONEOUS AND RAISES ISSUES OF STATUTORY INTERPRETATION THAT THEMSELVES MERIT REVIEW.

*Amici* recognize that this Court does not grant certiorari simply because a lower-court decision is notably erroneous. But error surely adds weight when, as here, there are other compelling reasons for review. And in this case the error of the Court of Appeals' well-meaning but entirely superficial opinion is palpable.

### A. The Court of Appeals, Believing It Was Preventing a "Windfall" to Taxpayers, Gravely Misunderstood § 809.

The Government constantly hammered to the Court of Appeals that the mutual companies were seeking a "windfall," [19] and that something must be amiss if, because of

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[18] For other examples see, *e.g.*, *Watt* v. *Western Nuclear, Inc.*, 462 U.S. 36, 42 (1983) ("[i]n view of the importance of the case to the administration of more than 33 million acres" "an issue of first impression in the federal courts"); *American Federation of Musicians* v. *Wittstein*, 379 U.S. 171, 175 (1964) ("the question being an important one of first impression under the LMRDA"); *United States* v. *Zazove*, 334 U.S. 602, 605 (1948) ("certiorari to review the important question of statutory construction involved").

[19] See, *e.g.*, Government's Reply Brief at 4 ("multibillion dollar windfall"), 8 ("windfall") (twice), 9 ("windfall"), 10 ("huge windfall tax deductions"), 11 ("windfall deductions") ("multibillion dollar windfall deduction"), 12 ("windfall") (twice). See also

the operation of § 809(f)(2), the life insurance deduction computed in 1987 turned out together with the § 808(c) policyholder dividend deduction for 1986 to exceed 1986 policyholder dividends. The Court of Appeals completely accepted the argument, opening its opinion by inaccurately announcing that "[t]he issue in this case is whether Congress intended to give mutual life insurance companies so-called dividend deductions greater than their dividends in any given year." P.C.A. 1a-2a.[20] The court's conclusion, which it described as carrying out "the purpose of the statute," was simple:

> "AMLI is not entitled to deduct an amount greater than its dividends."

P.C.A. 5a. The court unfortunately both misunderstood the purpose of the statute, and rejected the plain command of the statute's language.

1. The Court of Appeals' opinion rests on an assertion —it is no more than that—that the calculation prescribed in § 809(f)(1) and § 809(f)(2), "should," P.C.A. 7a, never result in a "life insurance deduction" and "policyholder dividend deduction" greater than policyholder dividends for the year in question. The statute does not say that. The statutory formula, which compares different years, contemplates that the opposite may occur.

Section 809(f)(2), captioned "Deduction where recomputed amount smaller," provides in full:

> "In the case of any mutual life insurance company, if—
>
> > "(A) the differential earnings amount determined under this section for any taxable year, exceeds

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Tr. of Oral Arg. 37-38 ("windfall deductions") ("pure and simple windfall") ("they would be getting a windfall").

[20] The "life insurance deduction" of § 809(f)(2) is not, of course, a "so-called dividend deduction."

> "(B) the recomputed differential earnings amount for such taxable year,
>
> such excess shall be allowed as a life insurance deduction for the succeeding taxable year."

Here there is no dispute that (A) was $9,826,925. There is no dispute that, unless the statutory formula is ignored and an artificial limit added, (B) was —$1,580,476. Unless every mathematician from Pythagoras to Einstein has been wrong, $9,826,925 exceeds —$1,580,476 by $11,407,401. That ought to be the end of the matter.

2. The Government relentlessly warned that unless the court reversed the District Court, mutual companies would receive a "windfall." No such thing. The final computation required by § 809 is not tied at all to dividends. It is simply a rough method to "impute" additional income to mutual companies. The purpose of § 809 was not to tinker with the "policyholder dividend deduction" established in §§ 805 and 808, but rather to create a new formula that would charge mutual life insurance companies for an amount of taxable earnings that could not be identified in their books. The formula took no account of the actual experience of any particular taxpayer company, *and it made no reference to dividends.* Instead, it looked only to industry averages—and averages from different sets of years at that. It compared an earlier three-year average of the earnings rate of stock companies with the rate of return for mutuals in a subsequent year. Subtracting the mutuals from the stocks gave a rate which, multiplied by each mutual company's equity value, was assumed to be the proper adjustment to its taxable income for the later year. This amount depended entirely on multiplying the rate times the size of the company's equity—not on how much it paid that year in dividends to policyholders, indeed, not even on whether it paid or accrued any policyholder dividends at all.

3. The Court of Appeals reasoned that because Congress (correctly) expected that stock rates usually would

exceed mutual rates *in any given year*, therefore Congress must also have intended that the industry comparisons of different periods enacted in the statute would also result in stock-company figures from one period higher than the mutual-company figures for a wholly different period. That is a *non sequitur*. Yet the heart of the Court of Appeals' opinion was its assertion that "whether Congress was right or wrong in its assumption, it expected, *and thus intended*, that 'excess' would be a positive number." P.C.A. 7a (emphasis supplied). The reference to "excess" in § 809(c)(1), the court suggested, implied that the result of subtraction would never be a negative number. That unsupported and acontextual characterization of the word "excess" was as close as the court ever came to any hook in the text for its legislative-intent holding. And such a reading not only is not linguistically plausible, but ignores the context of the statute itself, and makes no economic sense.

4. The Court of Appeals apparently believed that in 1986 something freakish had occurred: that "the operative assumption behind the section 809 formula . . . turned out to be wrong in 1986." P.C.A. 7a. "Neither the recomputed differential earnings rate nor the recomputed differential earnings amount *should* be negative." *Id.* (emphasis supplied.)[21] But the court's factual assumption was mistaken. There was no inversion in 1986. In that year stock company returns on equity, as usual, did exceed those of mutual companies. What made the number negative was that the statute's formula compares average stock company returns on equity from *one period* (here 1983-1985) with mutual company returns from a *later period* (here 1986). Insurance industry returns fluc-

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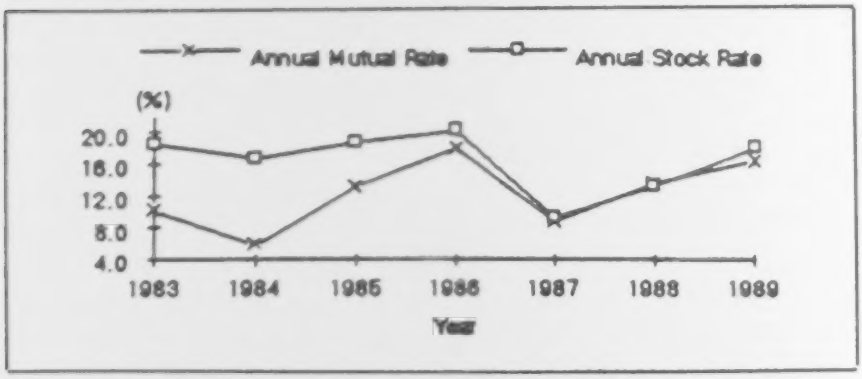
[21] Yet the Government had acknowledged that a negative result was not unusual at all. See Government's Reply Brief at 3; Tr. of Oral Arg. at 2, 9:

"Judge Magill: Is that unusual?

"[Government attorney]: It has not proven to be, Your Honor. . . . The last three out of four years have been negative."

tuate significantly from year to year. The following graph [22] illustrates the industry's ups and downs:




With wide annual fluctuation the norm for the industry, it is not surprising that *in a particular year,* here 1986, mutual returns—although still beneath stock company returns for that year—may exceed average stock company returns *for an earlier three-year period.* Thus negative numbers sometimes occur. They balance out over time.

5. The Court of Appeals decided to downgrade the "life insurance deduction" of § 809 to the status of a trivial delayed adjustment to the "policyholder dividend deduction" of § 808. In spite of the plain statutory formula of § 809(f)(2)—and in spite of the IRS's own prior acknowledgement of negative amounts, see p. 5a, *infra*—the Court of Appeals took the very step the District Court had recognized would be judicially improper. It read § 809(f)(2) as if Congress had added the words, "but the amount of such deduction for the year shall not exceed the differential earnings amount for the preceding taxable year." See P.C.A. 16a.

6. When a court decides to scrap statutory language because of supposed congressional intent, one would expect at least some clear and forceful statement in the legislative history that Congress had wanted to do what the

[22] See Plaintiff-Appellee's Petition for Rehearing, No. 94-1440, U.S.C.A., Eighth Cir., at 7.

court is ordering. But here there is nothing. The congressional committees' reports on § 809 nowhere suggest that the imputation of income is tied to dividends. See H.R. Rep. No. 98-432, 98th Cong., 2d Sess., Pt. II at 1425 (1984); S. Rep. No. 98-169, 98th Cong., 2d Sess. 552 (1984).

7. The fundamental flaw in the Court of Appeals' holding, apart from the fact that it undertakes to rewrite the tax code, is that it is utterly contrary to logic. Under the Court of Appeals' decision, when expectable annual fluctuations result in *increases* in imputed taxable income of mutuals, the mutuals will have to pay taxes on those increased amounts without any upward limit, and without any relation to what their policyholder dividends were in that year. That is required by § 809(f)(1). But in the years when fluctuations *reduce* imputed income, the Court of Appeals would arbitrarily cut off the reduction as soon as it exceeds the amount of policyholder dividends —in spite of the calculation plainly commanded by § 809(f)(2). The Government created a theory, which the court wrote into law, to eliminate only the fluctuations that favor the taxpayer. It amounts to "Heads, I win, tails, we don't count it." That may well be attractive to an energetic revenue collector, but it is disastrous for a taxpayer and an industry. The statute contains no such asymmetry.

**B. Contrary to This Court's Decisions, the Court of Appeals Substituted Its Concept of Unstated Congressional Intent for the Statutory Formula.**

The statute specifies a formula and a calculation. § 809(f)(2). When that calculation is done as the statute directs, it makes perfect sense that because of annual fluctuations, there will be a negative number in some years. Arbitrarily to treat years with negative numbers as zero makes no sense at all. Most importantly, even if the statutory formula resulted for 1986 in a figure the Court of Appeals could not understand, or incorrectly

viewed as a "windfall," nevertheless the inescapable fact is that that is the way Congress enacted this provision. The Treasury itself, until the present high-stakes litigation, recognized that the statute was designed independently to impute income, not to measure dividends. See DEPARTMENT OF THE TREASURY, FINAL REPORT TO THE CONGRESS ON LIFE INSURANCE TAXATION 25 n.8 (1989).[23]

The Court of Appeals in its policy arguments, as the petition demonstrates, has it all wrong, and ignores that its decision creates a statute that over time will severely harm mutual companies when there are sharp fluctations, but can never help them. But even if the Court of Appeals' policy were wise and sound, its freewheeling method of reconstructing the tax code was not. The District Court was exactly right in its homey observation that "[i]t is for Congress, not the courts, to rewrite statutes." P.C.A. 16a. This Court's decisions of course agree. *E.g., Blount* v. *Rizzi*, 400 U.S. 410, 419 (1971).

### C. The Court of Appeals' Deference to a Regulation Issued After Litigation Violates the Rule of *Skidmore* v. *Swift & Co.*

The Court of Appeals also made a ruling on basic administrative law that violates long established doctrine of this Court. The Court of Appeals pointed out that "[a]fter the district court issued its decision, the Internal Revenue Service issued regulations" announcing with retroactive effect that the figure computed under § 809 (f)(3) may not be less than zero. P.C.A. 8a; see 26 C.F.R. § 1.809-9 (1993), p. 6a, *infra*. The court said that this after-the-fact regulation was "entitled to great deference." P.C.A. 8a.

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[23] "The imputation of equity income was described as a limitation on policyholder dividend deductions, but in fact it is an income imputation. If the imputed income exceeds current policyholder dividends, the current reserve deduction is reduced by the excess." *Id.*

Under this Court's precedents such a regulation, which reverses by 180° a previous interpretation several years old, and is announced in the midst of litigation, is entitled to no deference at all. The familiar rule was first set forth in *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944): the weight to be given an interpretive regulation "will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all of those factors which give it power to persuade, if lacking power to control." See also *Mayburg* v. *Secretary of HHS*, 740 F.2d 100, 105-06 (1st Cir. 1984) (Breyer, J.).

By each of those criteria, the Government's after-the-fact regulation, issued nine years after the statute and renouncing its prior position, resoundingly flunks. An agency's "interpretation does not fare well under these standards" when it "contradicts the position which [it] had enunciated at an earlier date, closer to the enactment of the governing statute," and also "lacks support in the plain language of the statute." *EEOC* v. *Arabian American Oil Co.*, 499 U.S. 244, 257-58 (1991), quoting in part *General Elec. Co.* v. *Gilbert*, 429 U.S. 125, 142 (1976). The "changed view" of an agency "does undercut the argument that the regulations are entitled to deference." *North Haven Bd. of Educ.* v. *Bell*, 456 U.S. 512, 523 n.12 (1982). Even when an agency has not, as here, reversed itself, this Court will "reject the administrative interpretation of the statute" that is "inconsistent with the statutory mandate." *SEC* v. *Sloan*, 436 U.S. 103, 118, 119 (1978). The Court of Appeals' "great deference" to a tendentious regulatory backtracking upsets established jurisprudence and should not be allowed to stand.

## CONCLUSION

For the reasons stated herein and in the petition, certiorari should be granted.

Respectfully submitted,

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September 20, 1995

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# ADDENDA

## ADDENDUM A

DEPARTMENT OF JUSTICE

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FOR IMMEDIATE RELEASE
THURSDAY, JUNE, 22, 1995

TAX
(202) 616-2765
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### TAX ATTORNEY RECEIVED THE JOHN MARSHALL AWARD FOR SAVING TAX PAYERS FIVE BILLION DOLLARS

WASHINGTON, D.C.—David I. Pincus, a reviewer in the Appellate Section of the Tax Division of the Department of Justice, today received the John Marshall Award in the category of Handling of Appeals. Pincus' handling of a life insurance case helped save the U.S. Treasury five billion dollars.

Michael R. Stiles, the United States Attorney for the Eastern District of Pennsylvania cited Pincus for "his dedicated and exceptional efforts in developing the winning theory for the government in its victory in American Mutual Life Insurance Company v. United States." In that case, an appellate court reversed a district court decision.

Named for the fourth Chief Justice of the United States, the John Marshall Award recognizes exceptional achievement by attorneys of the Department of Justice in seven areas, including one for the handling of appeals.

# # #

95-355

**ADDENDUM B**

INTERNAL REVENUE SERVICE
ANNOUNCEMENT 88-47
1988-12 Int. Rev. Bull. 56

[March 21, 1988]

# DIFFERENTIAL EARNINGS RATE FOR MUTUAL LIFE INSURANCE COMPANIES

This announcement concerns the determination under section 809 of the Internal Revenue Code of the "differential earnings rate" for 1987 and the rate that is used to calculate the "recomputed differential earnings amount" for 1986. (The latter rate is referred to herein as the "recomputed differential earnings rate" for 1986.) These rates are used by mutual life insurance companies to calculate their federal income tax liability for taxable years beginning in 1987.

## BACKGROUND

Section 809(a) of the Code provides that, in the case of any mutual life insurance company, the amount of the deduction allowable under section 808 for policyholder dividends shall be reduced (but not below zero) by the "differential earnings amount." Any excess of the differential earnings amount over the amount of the deduction allowable under section 808 shall be taken into account as a reduction in the closing balance of reserves under subsections (a) and (b) of section 807. The "differential earnings amount" for any taxable year is the amount equal to the product of (a) the life insurance company's average equity base for the taaxble year multiplied by (b) the "differential earnings rate" for such taxable year. The "differential earnings rate" for the taxable year is the excess of (a) the "imputed earnings rate" for the taxable year over (b) the "average mutual earnings rate"

for the second calendar year preceding the calendar year in which the taxable year begins. The "imputed earnings rate" for any taxable year is the amount that bears the same ratio to 16.5 percent as the "current stock earnings rate" for the taxable year bears to the "base period stock earnings rate."

Section 809(f) of the Code provides that, in the case of any mutual life insurance company, if the "recomputed differential earnings amount" for any taxable year exceeds the differential earnings amount for such taxable year, such excess shall be included in life insurance gross income for the succeeding taxable year. If the differential earnings amount for any taxable year exceeds the recomputed differential earnings amount for such taxable year, such excess shall be allowed as a life insurance deduction for the succeeding taxable year. The "recomputed differential earnings amount" for any taxable year is an amount calculated in the same manner as the differential earnings amount for such taxable year, except that the average mutual earnings rate for the calendar year in which the taxable year begins is substituted for the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

As described above, the differential earnings rate for 1987 and the recomputed differential earnings rate for 1986 affect the income and deductions reported by mutual life insurance companies on their federal income tax returns for the 1987 taxable year.

Data necessary to determine the tentative differential earnings rate for 1987 and the tentative recomputed differential earnings rate for 1986 have been compiled from returns filed by mutual life insurance companies and certain stock life insurance companies. The Internal Revenue Service is currently examining these returns to verify the accuracy of the data reported on these returns. This ex-

amination will not be completed before the March 15, 1988, due date for filing 1987 calendar year returns.

## ANNOUNCEMENT OF TENTATIVE RATES

This announcement publishes a tentative determination of the differential earnings rate for 1987 and of the recomputed differential earnings rate for 1986. This announcement also publishes a tentative determination of several rates on which the calculation of the differential earnings rate for 1987 and the recomputed differential earnings rate for 1986 are based. The final determination of these rates is expected to be published before September 1, 1988. The final determination of other rates on which the calculation of the differential earnings rate for 1987 and the recomputed differential earnings rate for 1986 are based was published in Rev. Rul. 87-92, 1987-36 I.R.B. 9.

The tentative determination of the differential earnings rate for 1987 and the tentative determination of the recomputed differential earnings rate for 1986 that are published in this announcement should be used by mutual life insurance companies to calculate the amount of tax liability for taxable years beginning in 1987 (in the case of companies that file returns before an announcement of the final determination of these rates) or to calculate the amount of properly estimated unpaid tax liability for taxable years beginning in 1987 (in the case of companies that are allowed an extension of time to file returns). Companies that file returns before an announcement of the final determination of these rates should file amended returns after the final determination of these rates is announced. Any failure to pay tax for the 1987 taxable year before September 15, 1988, that is attributable to a difference between (a) the tentative determination of the differential earnings rate for 1987 and recomputed differential earnings rate for 1986 and (b) the final determination of these rates will be treated as due to reason-

able cause and will not give rise to any addition to tax under section 6651 of the Code.

The tentative determination of the rates is set forth in Table 1.

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure. See Rev. Rul. 87-138, 1987-52 I.R.B. 17.

Announcement 88-47,

Table 1

Tentative Determination of Rates To Be Used For Taxable Years Beginning in 1987

| | |
|---|---|
| Differential earnings rate for 1987 | 3.647 |
| Recomputed differential earnings rate for 1986 | −1.700 |
| Imputed earnings rate for 1987 | 16.782 |
| Current stock earnings rate for 1987 | 18.533 |
| Stock earnings rate for 1986 | 20.185 |
| Average mutual earnings rate for 1986 | 17.985 |

## ADDENDUM C

Treasury Regulation § 1.809-9 (1993),
26 C.F.R. § 1.809-9

Computation of the differential earnings rate and the recomputed differential earnings rate.

(a) *In general.* Neither the differential earnings rate under section 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under section 809(f)(3) may be less than zero.

(b) *Definitions*—(1) *Recomputed differential earnings amount.* The recomputed differential earnings amount, with respect to any taxable year, is the amount equal to the product of—

(i) The life insurance company's average equity base for the taxable year; multiplied by

(ii) The recomputed differential earnings rate for that taxable year.

(2) *Recomputed differential earnings rate.* The recomputed differential earnings rate for any taxable year equals the excess of—

(i) The imputed earnings rate for the taxable year; over

(ii) The average mutual earnings rate for the calendar year in which the taxable year begins.

(c) *Effective date.* The regulations are effective for all taxable years beginning after December 31, 1986.

Michael P. Dolan,
*Acting Commissioner of the Treasury.*

Approved November 8, 1993

Leslie Samuels,
*Assistant Secretary of the Treasury.*

[Published in 58 Federal Register 64899, Dec. 10, 1993]

## ADDENDUM D

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FINAL REPORT
TO THE CONGRESS ON
LIFE INSURANCE COMPANY TAXATION

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Department of the Treasury
August 1989
[Pp. 25-26]

* * * *

B. Reasons for Enactment and Design of Section 809

Section 809 was enacted primarily to assure that mutual companies are taxed on a base that is neither greater or less than their economic income.[7] Congress believed that a portion of the policyholder dividends paid by mutual companies is a distribution of corporate earnings to the policyholders as owners. Because stock life insurance companies cannot deduct amounts paid to their shareholders as dividends, Congress thought it appropriate to impute equity income to mutual companies.[8]

To determine the amount of equity income, an imputation mechanism was chosen because there was no means available to segregate and measure directly the ownership return of participating policies. Thus, section 809 oper-

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[7] *See* S. Rep. No. 169, Vol. 1, 98th Cong., 2d Sess. 521 (1984); H.R. Rep. No. 432, Prt. 2, 98th Cong., 2d Sess. 1397 (1984).

[8] The imputation of equity income was described as a limitation on policyholder dividend deductions, but in fact it is an income imputation. If the imputed income exceeds current policyholder dividends, the current reserve deduction is reduced by the excess. Section 809(a)(2).

ates to impute additional income to mutual companies based on a comparison of the returns on equity of the mutual and stock segments of the industry. Congress believed that profit-oriented enterprises generally distribute earnings to their owners in amounts that are proportional to the owners' equity in the business and, thus, determined that the equity earnings can be measured as a percentage of mutual company equity. Congress also believed that mutual and stock companies in the same industry will earn comparable rates of return on equity over a period of several years. It observed, however, that the average post-dividend, pre-tax return on equity of mutual companies was lower than that for a comparable group of stock companies. This difference, Congress concluded, was attributable to the tax-deductible distribution by mutual companies of earnings to their policyholders.

Congress therefore determined that the appropriate percentage of mutual company equity was generally equal to the difference between the average earnings rate of all mutual companies and the average of the earnings rates of the 50 largest stock comapnies. Congress believed, however, that the stock earnings rate should be adjusted so that the mutual segment of the industry would bear 55 percent of the aggregate industry tax burden for 1984. This allocation was thought appropriate in light of the historic allocation of the industry's tax burden between the mutual and stock segments, the relative percentages of assets held by the stock and mutual segments of the industry, and the difference in tax treatment at the individual level of mutual company policyholders and stock company shareholders.[9] Historical data on these relationships were presented in the 1988 interim report.

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[9] *See* S. Rep. No. 169, at 549; H.R. Rep. No. 432, at 1423.

Supreme Court, U.S.
FILED
SEP 29 1995
CLERK

No. 95-105

# In the Supreme Court of the United States

OCTOBER TERM, 1995

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AMERICAN MUTUAL LIFE INSURANCE COMPANY
AND SUBSIDIARIES,
*Petitioner,*

v.

UNITED STATES OF AMERICA

---

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit**

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## REPLY BRIEF FOR PETITIONER

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# In the Supreme Court of the United States

OCTOBER TERM, 1995

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No. 95-105

AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,

*Petitioner*,

v.

UNITED STATES OF AMERICA

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**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit**

---

## REPLY BRIEF FOR PETITIONER

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1. In this, perhaps the largest federal income tax case ever brought before the Court, the government's brief hardly addresses the only issue that is relevant at this stage—whether this case warrants review. Focusing almost entirely on the merits, the government fails to refute any of Petitioner's arguments regarding the importance of the question presented and the urgent need for a definitive resolution now rather than later.

- Nowhere does the government deny that the legal issue at stake involves $5 billion dollars in industry-wide taxes.
- Nowhere does the government refute that this is an issue that affects the tax liability of every mutual life insurance company doing business in the United States.
- Nowhere does the government challenge the fact that unless this Court resolves the issue, there will be a multiplicity of litigation filed in virtually

every federal circuit. In fact, the government seems to endorse the desirability of this state of affairs. *See* Gov't Br. 17-18.

- Nowhere does the government deny that the court of appeals' decision places mutual life insurance companies at a competitive disadvantage to the more than 2,000 stock life insurance companies.[1]
- Nowhere does the government take issue with the fact that more than 100 million mutual policyholders and beneficiaries will be affected by the ultimate resolution of this question.

The government could hardly challenge any of the above because it is already on record in agreeing with Petitioner that this case is of utmost importance. A little over a year ago, after the government had lost in the district court, Department of Justice attorneys were asserting that "this case presents a complex and important issue of first impression . . . . [that] has industry-wide significance . . . ." [Government's] Unopposed Motion for Extension of Time for Filing Appellant's Brief, No. 94-1440 at ¶ 2 (8th Cir.) (filed on March 31, 1994); *see also* Brief for the Appellant, at i, No. 94-1440 (8th Cir.) (filed on May 2, 1994) (requesting oral argument "in view of the importance of the issue presented, which arises with respect to *all* mutual companies") (emphasis in original).

2. Apart from the government's elaborate effort to defend the court of appeals' decision on the merits, the only ground that it offers for opposing review is that there is no circuit conflict. But this is far from a neutral principle that consistently guides the government's liti-

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[1] The import of this case was recently underscored by a letter from the Iowa Commissioner of Insurance to the Solicitor General, urging the government to acquiesce in the petition so that this issue could be resolved sooner rather than later. *See* Supp. App. 1a. As that letter demonstrates, unless this Court resolves this issue, the uncertainty, along with mutual companies' "limited ability to access the capital markets," will have "a significant impact" on the future of the mutual life insurance industry. *Id.* 2a.

gating position. As demonstrated by petitions filed by the government as recently as this Term, the real principle guiding the government is not whether there is a circuit conflict, but whether the government has won or lost below. *See* Petition for Certiorari, *United States v. Xerox Corp.*, No. 94-2005 (filed June 7, 1995); Petition for Certiorari, *United States v. County of San Diego*, No. 95-128 (filed July 21, 1995) (involving state *ad valorem* taxes); *see also* Reply Brief for the United States, *United States v. American College of Physicians*, No. 84-1737, at 10, 11 (filed June 21, 1985); [Government's] Petition for Certiorari, *Commissioner v. Lincoln Sav. & Loan Ass'n*, No. 544 OT 1970 (filed Aug. 14, 1970); [Government's] Petition for Certiorari, *United States v. Atlas Life Ins. Co.*, No. 489 OT 1964 (filed Sept. 11, 1964).[2] In all of these tax cases, the government lost in the court of appeals and sought review in this Court, even in the absence of a conflict. Likewise here, if the court of appeals had affirmed the district court's decision in favor of the taxpayer, the government would have been urging the Court to grant review, using the same arguments as Petitioner has made about the importance of the question presented, notwithstanding the absence of a conflict. The government is simply incorrect when it suggests that it will seek review in a tax case in the absence of a conflict only when the adverse decision has been rendered by the Federal Circuit. *Atlas* resulted from a Tenth Circuit decision; both *San Diego County* and *Lincoln Savings* arose from the Ninth Circuit.

3. The government's misunderstanding of the statutory provision at issue runs so deep that, even in its statement of the question presented, the government makes no fewer than three critical errors. First, the government refers to the relevant year as "a year in which the average mutual company earnings rate exceeds the average stock company rate." Gov't Br. (I). Section 809, however, *never* compares a one-year average of mutual company

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[2] Relevant excerpts of these petitions are quoted in the Brief *Amici Curiae* at 6 n.8, 9 n.13, and 10 n.15.

earnings rates with the same one-year average of stock company rates. As stated clearly in the statute, the comparison is between a one-year mutual company average and a prior three-year stock company average.[3] Second, the government asks whether the mutual company is allowed to "take a policyholder dividends deduction." *Id.* The Section 809(f)(2) deduction at issue, however, is explicitly referred to as a "life insurance deduction," which, as Sections 804 and 805 demonstrate, includes many more kinds of deductions than just a policyholder dividend deduction. Finally, the government explicitly ties what it terms the "policyholder dividend deduction" to the "actual amount of [a mutual life insurance company's] dividends," a link that is simply nonexistent in the statutory language. The government employs this sloppy and misleading terminology because it perceives that it is to its advantage to mix Section 808 with Section 809 and conflate the policyholder dividend deduction with the life insurance deduction. The court of appeals permitted the government to benefit from this approach, but this Court should not.

4. The government's "factual" explanation of Section 809 is a fanciful mixture of quotes from the statute, unstated assumptions, and imaginative statements of the statute's purpose made up from whole cloth. Perhaps most egregious are the government's claims that Section 809(f)(2) "compensates the company for its excessive reduction of its policyholder dividend deduction in the original taxable year," and that Section 809(f)(1) exists "to compensate the government for the excessive deduction taken in the original taxable year." Gov't Br. 5. The government's assertion that Section 809(f) was drafted to "compensate" the government (or the taxpayer) for an "excessive" deduction (or reduction) taken in the previous year is insupportable. Pursuant to Section

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[3] As the Brief *Amici Curiae* correctly points out, for 1986 (the year at issue), the average mutual company earnings rate was *not* greater than the average stock company earnings rate. *Amici* Br. 17.

809(a), mutual life insurance companies pay the correct amount of taxes due in the first year. If they are allowed to take a dividend deduction, they do so. Neither the government nor the taxpayers need to be "compensated" in the next year, for there was nothing "excessive" paid or deducted in the first year. The fundamental flaw in the government's argument is its unstated underlying assumption, namely, that the operation of Section 809 must somehow be tied to the amount of dividends actually paid by a mutual company in a given year. That assumption is false. There simply is no statutory language that connects the amount of income imputed or the amount of deductions allowed to the amount of dividends paid in any single year. Indeed, it is undisputed that Section 809(f)(1) specifically commands the imputation of income even if no dividends at all have been paid, and that the amount of such imputed income does not depend in any way on the amount of policyholder dividends accrued or paid in any given year.

Moreover, the government's assumption cannot be reconciled with the mechanism chosen by Congress, which is a multi-year formula that compares a one-year mutual average to a *prior three-year* stock average. Although the government acknowledges in its statement of the case that the statute mandates this apples-and-oranges comparison, the government then seeks to gloss over the significance of this fact for the statute's proper operation. *Compare* Gov't Br. 3-5 *with id.* 15 n.9. It is precisely *because* Congress chose to employ a multi-year formula that the statutory construction urged by the government is so flawed. By building in the requirement that earnings rates from different stages of the economic cycle be compared with each other, Congress virtually ensured that the recomputed differential earnings rate would be negative for some years (even if, for any given year, the stock earnings rate was higher than the mutual earnings rate). Congress having created such a multi-year comparison and the resulting negative differentials, it is peculiar indeed to argue, as the government does, that Congress

simultaneously intended to ignore such negatives, especially when Congress did not say anything to indicate such an intent.

As demonstrated in the petition, *see* Pet. 6-9, the multi-year formula chosen by Congress, if it is to function in a statistically valid way, must be interpreted to include the years in which negative results are obtained. Significantly, the government does not dispute that the statistical analysis provided by Petitioner is correct.[4] Instead, it admits that its reading of Section 809 essentially mandates that the overall tax liability of a mutual life insurance company depends on whether industry earnings rates fluctuate or remain in steady-state. If the rates are in steady-state, then no negatives arise and the mutual industry pays a certain percentage. If, however, the rates fluctuate, as they inevitably do, the mutual life insurance industry must pay a *higher* rate. The government offers no explanation why Congress would have wanted the tax liability for an entire industry to hinge upon such a whimsical factor.[5] The government completely misses the mark in stating that Petitioner is urging a certain "policy" in its interpretation of the Section. It is not a policy that Petitioner urges, it is merely sensible statutory interpretation, because it makes absolutely no sense to interpret the statute the way the government does.

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[4] The government's only comment on the statistical evidence is to ridicule Petitioner's "concept of statistical purity." Gov't Br. 15 n.9. Yet, this is not an abstract concept, and the government's comment tries to denigrate without denying that the results are factually accurate. One can certainly accept the proposition that Congress chose the multi-year formula to smooth out tax liabilities for mutual companies without at the same time accepting the further and very different proposition that Congress intended to ignore the negatives produced by its formula.

[5] The government attempts to justify the result as a simple mistake that was contrary to Congress's expectations. *See* Gov't. Br. 8. Yet Congress had no expectations about what the result of its multi-year formula would be. It only expected that on a year-to-year comparison, the average stock earnings rate would be greater than the average mutual earnings rate. As demonstrated in the Brief *Amici Curiae*, this expectation has generally held true.

5. The "common-sense understanding of Congress's intent," Gov't Br. 12, urged by the government has nothing to do with common sense and everything to do with rhetoric. Petitioner does not disagree that Section 809 was enacted to impose increased taxes on the mutual life insurance industry. The only question is how draconian that increase was intended to be. Despite the government's rhetoric that Petitioner's interpretation, if accepted, would create a "windfall" for mutual companies, nothing could be further from the truth. Even under Petitioner's interpretation, Section 809 functions to reduce mutual companies' deductions for policyholder dividends and thus to increase their taxes. If Section 809, as interpreted by Petitioner, is the government's idea of a "windfall," it is one that the industry gladly would forgo.

6. Contrary to the government's assertion, the court of appeals did not rule in the government's favor on two independent grounds. Although the Eighth Circuit did suggest that Section 808 should be read to limit Section 809, it did not state that its ruling could be supported by this reasoning even if the court were to have rejected the government's reading of Section 809 itself. *See* Pet. App. 5a-6a. Moreover, the government neglects to inform this Court that Sections 804 and 805 of the statute do not support the government's narrow reading of the term "life insurance deduction." According to the government that term refers to "both the policyholder dividends deduction . . . and the reserve deduction." Gov't Br. 14. Yet Sections 804 and 805 define "life insurance deduction" to include no fewer than eight enumerated deductions, including a catch-all "other deductions" category. *See* 26 U.S.C. §§ 804, 805(a)(8). Although policyholder dividend deductions may be a species of life insurance deductions, it can in no way be said that the "life insurance deduction" in Section 809(f)(2) refers solely to a policyholder dividend deduction or a reserve deduction.

In any event, the government fails to mention that the district court rejected out-of-hand the argument that Section 808(c) implicitly limits Section 809, when that theory was presented in the absence of the "winning theory" (first raised in the court of appeals) that under Section 809 the recomputed differential earnings rate can never be negative. As the district court held, there simply is no statutory language or legislative history that supports the government's attempted reliance on Section 808(c). Pet. App. 16a. Instead, although the Section 808(c) policyholder dividend deduction is explicitly limited by Section 809, the life insurance deduction authorized by Section 809(f)(2) is not limited by Section 808. And when Congress decided to enact Section 809(f)(2) without tying it to the amount of policyholder dividends paid in a given year, it must be assumed that Congress knew what it was doing. In this case, the district court gave the proper deference to Congress, stating that "[i]t is for Congress, not the courts, to rewrite statutes." Pet. App. 16a.

Furthermore, an important part of the government's argument that Section 808 limits Section 809(f)(2) is that otherwise Section 808 would be rendered a nullity. This simply is not true. In each year, Section 808(c) does exactly what it was drafted to do—it limits the policyholder dividends deduction taken in that year to the amount of policyholder dividends actually paid in that year. It is somewhat disingenuous for the government to state that a provision that limits the amount of policyholder dividends that a company can take in a single year is a nullity. Section 808(c) functions in the same way it was always intended to function, even under Petitioner's interpretation of Section 809(f)(2).

7. Although the government suggests that mere reference to a dictionary eliminates any question about the meaning of the statute, that notion is difficult to accept, given that the government itself has come up with diametrically opposed definitions of the language at issue. In this case the government has found it necessary to

define and then *redefine* the term "excess." Originally, the government (including the IRS and the government's hired expert and attorney in the district court) agreed with Petitioner that "excess" as used in Section 809(c) means "difference" and that therefore Section 809(c)'s formula produces negative rates in certain circumstances. For the government to argue now that there is only one true meaning of the word "excess" and that that meaning is readily apparent ignores the history of the government's own interpretation of this statute.

Petitioner does not quarrel, as the government suggests, with the government's power to correct an error in interpretation. Rather, the issue is whether there *was* any error in the first place. Obviously, the government was either wrong in its original interpretation or it is wrong now. Petitioner respectfully suggests that the government's initial neutral construction, made before any tax implications were known and before the government's approach to the legal issue presented here was skewed by the desire to enhance revenues, is more reliable. This Court's decisions involving the deference that should be given to after-the-fact agency interpretations of statutes suggests that it agrees with Petitioner's approach. *See Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944); *see also* Brief *Amici Curiae* 20 (citing cases). Notwithstanding this Court's precedent, the court of appeals stated that the agency interpretation in this case was "entitled to great deference." Pet. App. 8a.

As explained in the Petition, *see* Pet. 27, Congress knew exactly what it was doing by using the term "excess" in both Sections 809(a) and 809(f) in situations that refer solely to positive numbers. Both those sections provide specific instructions on what is to be done when one number is larger than the other. In both cases, Congress directed that the effects of Section 809 were to be applied in different ways based on whether one number was larger than the other. In contrast, Section 809(c) provides that only one calculation is to be performed.

By implication, it does not matter whether one number is larger than the other; the nature of the computation will be the same for all potential values of the variables involved. Hence, the synonym for "excess" in Section 809(c) is the noun "difference," not the government's verb "surpass."

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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September 29, 1995

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# APPENDIX

## SUPPLEMENTAL APPENDIX

STATE OF IOWA

TERRY E. BRANSTAD, Governor

Therese M. Vaughan, Commissioner

INSURANCE DIVISION
Iowa Department of Commerce

September 15, 1995

Hon. Drew S. Days, III
Solicitor General United States
Department of Justice
Tenth & Constitution Avenue N.W.
Washington, D.C. 20530

Dear Mr. Days:

As Commissioner of Insurance of the State of Iowa, I regulate the activities of a number of mutual insurance companies. As such I have a significant interest in the rights of their policyholders, the financial condition of individual companies, and the industry as a whole. The life insurance industry is an integral component of the economy and a vital resource for both the United States and its individual citizens. Life insurance constitutes a significant portion of the personal savings and investments for nearly two-thirds of all Americans. Additionally, life insurance companies provide the third largest domestic source of funds for the U.S. financial markets.

On July 19, 1995 American Mutual Life Insurance company filed a Petition For a Writ of Certiorari with the United States Supreme Court in the case of *American Mutual Life Insurance Company and Subsidiaries v. United States of America.* This case involves the proper interpretation and application of Section 809 of the Internal Revenue Code and is of great significance to the life insurance industry. At the present time, despite the opinion of the Eighth Circuit in this case, mutual life insurers are in a state of uncertainty with respect to their

future tax liabilities. $5 billion is at stake and the availability of the $5 billion currently at issue. While the Division of Insurance is not taking any position on the merits of this case, I believe, for the reasons set forth herein, that the issues involved in this case must be determined with certainty as soon as possible.

The life insurance industry is at a crucial turning point as a result of increasing competitive pressures from banks, mutual funds, and other financial institutions which have placed severe pressure on their profit margins. During this same period, the financial resources of these companies have undergone increased scrutiny from government regulators, rating agencies, and the public. The need for a strong capital and surplus position has never been more important for life insurance companies than it is now.

This pressure to respond to competition while simultaneously enhancing capital and surplus has created a significant dilemma for life insurers and especially mutual life insurers because of their limited ability to access the capital markets. It has caused many mutual insurers to reassess the fundamentals of their business and has contributed to significant consolidation in the industry as is demonstrated by the recently proposed mergers of Metropolitan Life and New England Life, and Massachusetts Mutual and Connecticut Mutual Life. Companies throughout the industry are currently weighing alternatives with respect to future competitive strategies, the continuation of their current legal structures for conducting business, and in some cases the continuance of their independent existence.

A key to any company's decision making and strategic planning is an evaluation of its capital and surplus position. Until the issues raised in the *American Mutual* case are finally resolved, the mutual insurance industry will remain uncertain about the treatment of $5 billion in revenues. These decisions will have a significant impact upon the future not only of those companies but of the

entire industry. To require companies to make these decisions without certainty about their current financial resources or their future tax liabilities is not only unfair to the companies, but also constitutes an injustice to their policyholders.

As the Commissioner of Insurance for Iowa, I have the responsibility for safeguarding the interest of the policyholders and the public in overseeing the operations and financial integrity of Iowa's insurance companies. Without taking any position on the merits of the *American Mutual* case, I am requesting that the government acquies[c]e in American Mutual's pending Petition and urge the Supreme Court of the United States to grant review of this case. Only in this way can mutual life insurance companies make fully informed decisions affecting their policyholders and their strategic direction.

Sincerely,

/s/ Terri M. Vaughan
TERRI M. VAUGHAN, Ph.D.
Commissioner of Insurance